Supreme Court, U.S.
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In the
Supreme Court of the United States

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THE BOEING COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

♦

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

♦

PETITION FOR A WRIT OF CERTIORARI AND APPENDIX VOLUME I

♦

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QUESTIONS PRESENTED

1. Whether the Due Process Clause of the Fifth Amendment permits an appellate court to adopt a new legal rule, inconsistent with its own prior ruling in the same case, and then apply it retroactively to the record established in the trial court pursuant to the prior ruling, without remanding to afford the parties the opportunity to prove their case under the new rule.

2. Whether the Due Process Clause of the Fifth Amendment permits the Government to maintain a claim while simultaneously asserting the state secrets privilege to bar presentation of a prima facie valid defense to that claim.

3. Whether the Government may terminate a government contract for default on the ground that a contractor has failed to make adequate progress toward timely completion of that contract where the Government has not set a valid deadline for completing the contract.

LIST OF PARTIES

Pursuant to Rule 14.1(b) and Rule 29.6, the following list identifies all the parties to the proceeding before the United States Court of Appeals for the Federal Circuit:

McDonnell Douglas Corporation, appellant below, was a wholly owned subsidiary of The Boeing Company prior to January 1, 2010. On January 1, 2010, McDonnell Douglas Corporation was merged into The Boeing Company, which brings this petition for a writ of certiorari as the corporate successor to McDonnell Douglas Corporation. The following publicly held companies own ten percent or more of the outstanding stock of The Boeing Company: State Street Corporation and its subsidiary State Street Bank and Trust Company as the trustee of The Boeing Company Employee Savings Plan Master Trust; Evercore Trust Company, N.A. as the investment manager of The Boeing Company Employee Savings Plan Master Trust.

General Dynamics Corporation, appellant below, has no parent corporation. No publicly held company owns ten percent or more of the stock of General Dynamics Corporation.

The United States.

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PETITION FOR A WRIT OF CERTIORARI

The Boeing Company, as corporate successor to the McDonnell Douglas Corporation ("McDonnell Douglas"), respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

♦

OPINIONS AND ORDERS BELOW

The opinions of the Federal Circuit (App. 74a-105a, 37a-73a, 1a-36a) are reported at 182 F.3d 1319, 323 F.3d 1006, and 567 F.3d 1340. That court's order denying McDonnell Douglas' combined petition for rehearing and rehearing *en banc* (App. 462a) is unreported. Pertinent opinions of the United States Court of Federal Claims (App. 411a-461a, 369a-410a, 299a-368a, 258a-298a, 106a-257a) are reported at 35 Fed. Cl. 358, 37 Fed. Cl. 270, 40 Fed. Cl. 529, 50 Fed. Cl. 311, and 76 Fed. Cl. 385.[1]

♦

JURISDICTION

The Federal Circuit entered final judgment on June 2, 2009, and denied McDonnell Douglas' timely petition for rehearing and rehearing *en banc* on

[1] References to the appendix included with this petition are designated as "App. ." References to the joint appendix filed with the Federal Circuit are designated as "JA ."

November 24, 2009. App. 1a-36a, 462a. On January 22, 2010, and March 12, 2010, the Chief Justice extended the deadline for filing this petition for a writ of certiorari, first to March 24, 2010, and then to April 23, 2010. Docket No. 09A-678. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

♦

CONSTITUTIONAL AND REGULATORY PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution provides in pertinent part: "No person shall . . . be deprived of life, liberty, or property, without due process of law. . . ."

Section 52.249-9(a)(1)(ii) of the Federal Acquisition Regulations, 48 C.F.R. § 52.249-9(a)(1)(ii) (1984), states: "The Government may . . . , by written Notice of Default to the Contractor, terminate this contract in whole or in part if the Contractor fails to . . . [p]rosecute the work so as to endanger performance of this contract."

♦

INTRODUCTION

This case arises from the Government's 1991 default termination of its contract with McDonnell Douglas and General Dynamics ("Contractors") to design and build the A-12 "stealth" aircraft. Over the course of almost two decades of litigation, the Federal

Circuit has twice denied Contractors due process, created multiple circuit splits, and thrown previously settled law in a critical area of government contracts jurisprudence into complete disarray. If allowed to stand, the court's rulings may well unjustly deprive Contractors of billions of dollars. This Court's review is necessary to settle these important legal issues and to resolve these conflicts among the circuits.

First, the Federal Circuit denied Contractors the most elemental feature of due process: fair notice of the governing legal standard and an opportunity to prove their case in the trial court under that standard. After initially directing the trial court to apply its clear, long-standing rule for evaluating default terminations – a rule it expressly prescribed as the "controlling standard" in this very case – the Federal Circuit, upon next review, *sua sponte* embraced an entirely different, "ad hoc" approach materially indistinguishable from one it had expressly rejected in its previous decision. Without remanding, the Federal Circuit then adjudicated Contractors' rights itself, applying its newly minted test to the pre-existing record, even though the case had been litigated under the very different rule it had previously mandated. The Federal Circuit's ruling conflicts with the decisions of this Court and other circuits and introduces substantial uncertainty regarding the principles of due process governing appellate adjudication. Furthermore, the grave miscarriage of justice worked by the appellate process in this case manifestly warrants the exercise of this Court's supervisory authority.

Indeed, in view of the Federal Circuit's patent error, summary reversal of this ruling is warranted.

Second, the Federal Circuit earlier worked an equally grave violation of Contractors' due process rights in this case by allowing the Government to press its claim for default termination while simultaneously upholding the Government's assertion of the state secrets privilege to bar Contractors from asserting a valid defense to that claim. In addition to conflicting with bedrock principles of due process embraced by this Court's precedents, the Federal Circuit's ruling creates a conflict among the circuits on the effect of the Government's invocation of the state secrets privilege. This case thus presents an important question regarding the accommodation of fundamental due process concerns with the needs of national security. Moreover, it comes to this Court at a time when the state secrets privilege is being asserted with growing frequency, and the need for clarity and uniformity on its scope and impact could not be more compelling.[2] And because this case presents the issue in the less politically charged context of a government contract dispute, it offers a rare opportunity to provide clarity in a vital area of the law

[2] *See, e.g.*, *Wilner v. NSA*, 592 F.3d 60, 77 n.8 (2d Cir. 2009); *Arar v. Ashcroft*, 585 F.3d 559 (2d Cir. 2009); *Mohamed v. Jeppesen Dataplan, Inc.*, 579 F.3d 943, *en banc granted*, 586 F.3d 1108 (9th Cir. 2009); *Rahman v. Chertoff*, 530 F.3d 622, 624-25 (7th Cir. 2008); *Al-Haramain Islamic Found., Inc. v. Bush*, 507 F.3d 1190 (9th Cir. 2007); *El-Masri v. United States*, 479 F.3d 296 (4th Cir. 2007).

"in a manner that is insulated from the pressures of the moment." *Noriega v. Pastrana*, 130 S. Ct. 1002 (2010) (Thomas, J., joined by Scalia, J., dissenting from denial of petition for writ of certiorari) (quotation marks omitted). This Court should take that opportunity.

Finally, the Federal Circuit's new ad hoc approach for reviewing government default terminations of fixed-price contracts represents a stark change in settled law, upon which public contractors have long relied in calculating the risks of doing business with the United States. The new approach is flawed and unworkable and will breed uncertainty and arbitrary outcomes at a time when the Government has publicly renewed its interest in fixed-price contracting. Indeed, the court's new approach may produce an unexpected and grossly unjust multi-*billion* dollar forfeiture in this case alone. And because it is highly unlikely that any other Circuit will address the issue of government contracts law presented here, the issue is ripe for review by this Court at this time.[3]

♦

[3] Petitioner agrees that the additional issues presented by General Dynamics Corporation in its petition for a writ of certiorari also warrant this Court's attention, Petition for Writ of Certiorari, *The Boeing Company v. United States*, No. (April 23, 2010), and joins General Dynamics' request that the Court review those issues, which equally affect both Petitioners.

STATEMENT OF THE CASE

A. The A-12 Contract

In 1988, Contractors entered into a fixed-price research-and-development contract with the United States Navy to develop the "A-12 Avenger," a state-of-the-art carrier-based "stealth" attack aircraft. App. 39a. The contract required Contractors first to develop a design for the aircraft acceptable to the Navy, and then to manufacture eight test aircraft of increasing complexity, with the first to be delivered in June 1990 and the remaining seven to be delivered on specified dates thereafter. App. 4a. The eighth test aircraft was to be a fully operational prototype. App. 260a. The A-12 contract also gave the Navy options to purchase four production lots of aircraft. App. 5a. The Navy exercised its first option ("Lot I") in May 1990 for six production aircraft, which were to be delivered between June 1991 and May 1992. App. 5a. The contract also provided for six phases of testing by Contractors, to be completed by April 1993, as well as contractor support for additional Navy testing and training until June 1996. App. 4a-5a, 119a.

B. Performance and Termination

Performance commenced in January 1988. From the beginning, Contractors' progress was hampered because the Air Force refused to share classified information and stealth technology from other programs, contrary to the mutual expectations and understanding of Contractors and the Navy. *See, e.g.*, App.

393a & n.9. Further, as the Navy well understood, deviations from schedule and specifications are all but inevitable in research-and-development programs like this one, which seek to advance the state of the art. *See, e.g.*, App. 124a, 117a-48a; JA 15,623, 16,541, 71,217; 48 C.F.R. § 35.002.

Accordingly, the Navy and Contractors agreed early on to address technical issues as they arose, rather than attempt to adhere rigidly to contract schedule and specifications. App. 5a; JA 2,279-80. By 1989, the Navy knew that the original schedule for delivery of the eight test aircraft would not be achieved and that the aircraft would exceed the originally specified weight. *See, e.g.*, JA 2,269-70, 18,936; App. 447a.

In June 1990, Contractors projected that first flight would be delayed until between July and September 1991, and that there would be a corresponding slippage of twelve to fourteen months for the remaining contract work. Although Contractors thus missed the milestone for delivering the first test aircraft, the Navy took no action to terminate the contract. App. 5a. To the contrary, on August 17 the Navy unilaterally issued a contract modification, called "P00046," as "a first step" toward establishing a more realistic contract completion schedule. *See* JA 2,368. This modification set a new schedule for delivering the eight test planes, but did not address the schedule for subsequent stages of performance. App. 6a. Because the original schedule for the subsequent performance was irreconcilable with (and therefore

displaced by) P00046, there was no longer any binding completion date for the entire contract. App. 16a, 31a, 110a-11a, 243a-44a. The Navy and Contractors intended to negotiate a new schedule for the remainder of the contract effort after they agreed on the A-12 design. *See, e.g.*, JA 1,067-68, 2,360-61, 2,368, 71,088.

Contractors continued to perform, at a cost to them of $120-150 million per month. App. 7a. During the fall of 1990, the parties resolved all outstanding design issues. App. 125a-30a. Among other things, the Navy accepted Contractors' modified weight projections. App. 288a. Concluding that "technical concerns had been addressed and resolved to its satisfaction[,] [t]he Navy accepted plaintiffs' design for the A-12 in November 1990." App. 130a.

Rather than re-establish a reasonable completion schedule, as the parties had intended, however, the Navy abruptly issued a cure notice in December 1990 and, on January 7, 1991, terminated the contract for default pursuant to Federal Acquisition Regulation ("FAR") 52.249-9(a)(1)(ii). That provision authorized termination for default if Contractors "fail[ed] to . . . [p]rosecute the work so as to endanger performance of this contract." 48 C.F.R. § 52.249-9(a)(1)(ii) (1984); App. 8a-9a.[4] As grounds, the Navy asserted Contractors'

[4] The Government also invoked FAR 52.249-8(a)(1)(ii), the analogous regulation governing the production option exercised by the Government. As relevant here, there is no material difference between these two provisions.

projected failure to meet (1) the interim P00046 schedule, (2) the original Lot 1 production schedule (though displaced by P00046, *see* App. 16a, 243a), and (3) original design requirements – particularly, weight requirements – even though the Navy had accepted a modified design just weeks before (*see* App. 129a-30a & n.11). JA 18,297.

Based on this claimed default, the Navy not only refused to reimburse Contractors for more than $1.2 billion in out-of-pocket costs incurred before termination, it also demanded that Contractors return approximately $1.35 billion in allegedly unliquidated progress payments. App. 9a-10a. To date, approximately $1.5 billion in interest has accrued on the principal balance claimed by the Government.

C. The First Round of Litigation

In June 1991, Contractors sought review of the Navy's decision in the Court of Federal Claims under the Contract Disputes Act, 41 U.S.C. § 609(a). Although that statute required Contractors to initiate this action, they are the plaintiffs in name only. "[A] government decision to terminate a contractor for default is a government claim," *Malone v. United States*, 849 F.2d 1441, 1443 (Fed. Cir. 1988), and the Government, accordingly, had the burden of proving that its default termination, and a potential multi-billion dollar penalty, were justified, *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759, 764 (Fed. Cir. 1987). Contractors argued that the Government could

not satisfy its burden and that the termination should therefore be converted into one for the convenience of the Government. *See* FAR 49.401(b), 52.249-9(g). Contractors also sought their unreimbursed costs incurred in performing the contract.

After several years of litigation, the trial court held that the default termination could not be sustained because it had been pretextual, and the contracting officer had not exercised reasoned discretion in invoking this draconian remedy. App. 343a-44a. That court also expressly rejected the Government's arguments that Contractors had repudiated the contract or otherwise failed to give adequate assurances of performance. App. 458a-61a. The court awarded Contractors $1.2 billion in unreimbursed costs, plus interest. App. 367a-68a.

The Federal Circuit reversed, holding that "because the termination for default was predicated on contract-related issues, it was within the discretion of the government." App. 75a-76a. The court remanded for determination of whether the Government could prove that Contractors were in default. App. 104a-05a.

D. The Second Round of Litigation

On remand, the trial court sustained the default termination based solely on its finding that Contractors would not have met the December 1991 "first flight" milestone set by P00046. App. 255a-75a. That court rejected all other grounds for default termination the Government alleged – including that

Contractors could not meet weight and other specifications, that Contractors' financial condition threatened performance, and (once again) that Contractors failed to give adequate assurances of performance. *See, e.g.*, App. 264a-65a.

That court also rejected Contractors' "superior knowledge" defense, which was premised on the Government's "duty to disclose critical information to a contractor that is necessary to prevent the contractor from unknowingly pursuing a ruinous course of action," App. 96a (quotation marks omitted). The court found that this duty extended to the Air Force's extensive knowledge of stealth technology, and Contractors argued that they could have used that superior knowledge to avoid the extensive, duplicative, and time-consuming efforts they expended to solve technical problems in designing the A-12. App. 381a-82a & nn.6-7; *see also* App. 137a n.16 (Deputy Assistant Secretary of Defense for Procurement "relented" in her opposition to "putting the A-12 out for bids on a fixed-price contract . . . only with assurance that the Government would share its stealth technology with the contractors. Otherwise, she predicted, it cannot be done.").

The Government, however, invoked the state secrets privilege to block discovery relating to its superior knowledge. App. 383a-86a. That privilege applies if "there is a reasonable danger that compulsion of the evidence will expose military matters which, in the interest of national security, should not be divulged." *United States v. Reynolds*, 345 U.S. 1, 10

(1953). The trial court found that Contractors could "present a *prima facie* case based on A-12 program information alone." App. 394a-95a, 402a; *see also* App. 293a-94a. But the court sustained the privilege and rejected the defense because, it concluded, the "superior knowledge issues in this case cannot be litigated safely." App. 292a-93a.

In its 2003 decision ("*MDC 12*"), the Federal Circuit vacated the judgment in favor of the Government and remanded. The appellate court "reaffirm[ed] . . . that the test . . . adopted in *Lisbon [Contractors, Inc. v. United States*, 828 F.2d 759 (Fed. Cir. 1987)], as further explained in this opinion, controls the review of default termination for failure to make progress." App. 58a. Specifically prescribing *Lisbon* as "the controlling standard" in this case, App. 72a-73a, the court held that the Government – which "bore the burden of proof in justifying a default termination" – must show "'reasonable belief on the part of the contracting officer that there was no reasonable likelihood that the contractor could perform *the entire contract effort within the time remaining for contract performance*,'" App. 52a (quoting *Lisbon*, 828 F.2d at 765) (emphasis added).

The Federal Circuit further held that, under *Lisbon*, the trial court's finding that Contractors would not have met P00046's first flight date in December 1991 was "insufficient to sustain a default termination in this case." App. 47a. It vacated the trial court's ruling that the default termination was justified and remanded for further proceedings "because the

Court of Federal Claims did not apply the controlling standard under *Lisbon* to this case." App. 72a. The court specifically directed that "on remand, *once* the Court of Federal Claims determines the performance required by the contract *and the contract completion date*, it can *then* decide . . . whether the government has met its burden" of justifying the default termination under *Lisbon*. App. 57a (emphasis added); *see also* App. 56a ("the Court of Federal Claims will *first have to decide* the actual performance that the contract requires and the amount of time remaining for performance") (emphasis added). For, as the court explained, "[u]nless the contracting officer had determined the entire effort required under the contract and the time left to complete the contract, it would be difficult, if not impossible, for him to resolve whether 'there was no reasonable likelihood that the contractor could perform the entire contract effort within the time remaining for contract performance.'" App. 56a (quoting *Lisbon*, 828 F.2d at 766) (emphasis altered).

Turning to the superior knowledge defense, App. 39a-42a, 58a-72a, the Federal Circuit rejected Contractors' argument that the Government could not, consistent with due process, both continue to assert its claim for default termination and also invoke the state secrets privilege to foreclose Contractors' superior knowledge defense to that claim. App. 69a-70a. Asserting that Contractors had "conflate[d] rules governing criminal and civil proceedings," the court concluded that the trial court had not erred in

barring Contractors' defense while allowing the Government's claim to proceed. App. 69a.

E. The Third Round of Litigation

On remand, the trial court specifically determined that "[t]he contract had no completion date at termination, seemingly leaving the court without a basis for finding a reasonable belief on the part of the contracting officer that the contractors would not complete the work on time." App. 243a-44a. Under *Lisbon*'s plain language, *and MDC 12*'s even plainer, repeated remand instructions quoted above, the Government could not prove that Contractors had failed to make sufficient progress toward timely completing the entire contract effort if there was *no valid completion date*. App. 109a-11a. Rather than vacate the default termination, however, the trial court turned again to the interim, partial P00046 schedule and used it as a "yardstick" for measuring performance under *Lisbon*; it concluded that the "trial record supplies reasons that a contracting officer might have deemed himself insecure *if he were considering the period of performance identified as the 'yardstick.'*" App. 211a (emphasis added).

Given that the P00046 yardstick "use[d] a contract period before the ultimate completion date" and addressed only one of more than 80 contract line items, the court had to acknowledge that its analysis showed only that "the contractors were behind schedule at termination according to a self-contained series

of milestones, *not in relation to the entire contract*," App. 206a (emphasis added), as *Lisbon* and *MDC 12* required. Indeed, the trial court openly acknowledged that its analysis could not be squared with the *MDC 12* mandate if that mandate's words were construed "to mean exactly what they appear to mean." App. 256a n.92. The court thus defied the Federal Circuit's specific remand instructions; readopted its prior, rejected analysis; and conceded as much. App. 196a.

In its decision in 2009 ("*MDC 14*"), the Federal Circuit agreed "that the contract, as modified by P00046, does not provide a definite contract completion date." App. 16a, 31a. Under the *Lisbon-MDC 12* rule, therefore, it should have reversed the trial court's decision sustaining default termination. Instead, the Federal Circuit *affirmed*, candidly acknowledging that it was now adopting an analysis that "may appear different from the one [it had] previously instructed the trial court to perform." App. 30a n.4. That court invoked supposed authority under the law of the case doctrine to justify its acknowledged "depart[ure]" from *MDC 12*. *Id.* Whereas *MDC 12* identified *Lisbon* as the "controlling standard," under which the trial court must determine "the performance required by the contract and the contract completion date" as a prerequisite to sustaining the default termination, App. 57a, *MDC 14* ruled that "because the modified A-12 contract does not contain a fixed completion date, a *Lisbon* analysis cannot be strictly applied," App. 31a; *see also* App. 17a (refusing to "apply the *Lisbon* test literally").

Instead, *MDC 14* created a new "ad hoc, factual inquiry," requiring a termination for default to be upheld, *even absent a contract completion date*, if the Government shows that, in light of "all relevant circumstances," "the contracting officer was reasonably justified in *feeling insecure* about the contractors' rate of progress." App. 22a, 29a (emphasis added). The court held that "[o]nce the Government has met this burden of proving that timely performance is beyond the contractors' reach, the contractors have the burden of going forward to prove either that they were making progress such that timely completion of the contract was not endangered or that there was excusable delay." App. 31a. The court thus not only shifted to Contractors the burden of proof on what had been the ultimate question under the *Lisbon-MDC 12* rule – whether "timely completion of the contract" is endangered – but also removed altogether the only objective metric – a completion date – by which that inquiry could be answered.

Attempting to justify its abrupt repudiation of the *Lisbon-MDC 12* rule, the Federal Circuit invoked what it characterized as "the unique facts of this case and the disadvantage [the court] faced [in *MDC 12*] when deciding the case without the benefit of sufficient fact findings from the trial court." In particular, the court lamented that *MDC 12*'s "specific instruction" for the trial court to determine "the contract completion date . . . , *if read literally, turns out to be difficult to apply*." App. 15a (emphasis added).

MDC 12, however, had already considered the "unique facts of this case." That court was fully aware

of the parties' "differing views of the contract completion date," including Contractors' position "that no such date existed." App. 56a.[5] But *MDC 12* never suggested that *Lisbon* would not apply absent a completion date; on the contrary, it specifically noted that "it would be difficult, if not impossible," for the Government to carry its burden of justifying the default termination absent such a date. *Id.* Furthermore, *MDC 12* had squarely rejected the Government's arguments then: (i) that "the circumstances in this case are so different that [the court] should not seek guidance from precedent" such as *Lisbon*; (ii) that default termination should therefore be assessed *solely* by looking "at the contractors' conduct in context, in all the facts and circumstances," and (iii) that default termination "was appropriate here given the Contractors' admitted inability to meet an interim contract milestone, the alleged impossibility for the aircraft design to meet contract specifications, and the Contractors' request for a restructuring of the agreement." App. 50a; JA 90,075-76 (oral argument). Yet, *MDC 14* later invoked these same essential arguments in *upholding* the default termination. *MDC 14* thus embraced an analysis materially indistinguishable from that expressly rejected by *MDC 12*.

Despite the crucial differences in proof between its new ad hoc approach and the clear rule it discarded, the Federal Circuit, incredibly, did not remand to

[5] As discussed below, lack of a completion date at termination hardly rendered this case "unique" or the *Lisbon* analysis "difficult to apply." *See infra*, Part III.

require the Government to meet its new burden or to afford Contractors a chance to rebut the Government's showing, to present defenses under the new standard, or to meet the burden the court had newly shifted to them. Rather, the court applied its new test to the record formed under the fundamentally different *Lisbon-MDC 12* rule. Thus, the court sustained the default termination because it believed, based on its own interpretation of the facts, that the Government "was justifiably insecure about the contract's timely completion" and because Contractors neither proffered "record evidence to show . . . that they could have completed the contract *on any date*" nor argued on appeal "that their failure to make progress could be excused." App. 30a (emphasis added). Of course, Contractors had had neither reason nor opportunity to make either showing.

♦

REASONS FOR GRANTING THE PETITION

I. The Federal Circuit's Adoption and Application of a New Legal Rule without Remanding Violates Due Process and Conflicts with this Court's Precedents and the Decisions of Other Circuits.

In *MDC 12*, the Federal Circuit clearly directed that this case be litigated and decided under the *Lisbon* rule. As this Court's precedents and the decisions of other circuits make clear, once the appellate court changed the applicable legal standard, the Due Process Clause entitled Contractors, as a matter of

basic fairness, to a remand so they could present argument and evidence made newly relevant by the Federal Circuit's about-face. Had they been afforded that opportunity, Contractors almost certainly would have prevailed.

A. The Federal Circuit's Refusal to Remand Conflicts with This Court's Precedent.

"[T]he Due Process Clauses protect civil litigants who seek recourse in the courts, either as defendants hoping to protect their property or as plaintiffs attempting to redress grievances." *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 429 (1982). Due process manifestly requires "notice and a meaningful opportunity to be heard." *Lachance v. Erickson*, 522 U.S. 262, 266 (1998). More specifically, a "party is entitled, of course, to know the issues on which decision will turn." *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 289 n.4 (1974). Consequently, when a court "overrules a consistent line of . . . decisions with the retroactive effect of denying a litigant a hearing in a pending case, it thereby deprives him of due process of law." *Bouie v. City of Colombia*, 378 U.S. 347, 354 (1964); *see also Gonzales v. United States*, 348 U.S. 407, 414 & n.5 (1955).

It follows that a court must remand when it announces a rule different from the one under which the case has been litigated. This principle is so fundamentally obvious that courts ordinarily apply it as a matter of course. For example, in *Hertz Corp. v.*

Friend, this Court recently adopted a jurisdictional test for identifying a corporation's principal place of business that differed materially from the standard under which the parties had litigated the case. 130 S. Ct. 1181, 1186-87, 1191-94 (2010). Even though the plaintiffs had not previously challenged the defendant's declaration relating to its principal place of business, this Court vacated the decision below and remanded to afford the respondents "a fair opportunity to litigate their case in light of [its] holding." *Id.* at 1195.

These bedrock principles of due process apply with special force here, for it is well-established that default termination is "a drastic sanction," *Lisbon*, 828 F.2d at 765 (citation omitted), indeed, "a species of forfeiture," *Decker & Co. v. West*, 76 F.3d 1573, 1580 (Fed. Cir. 1996). As this Court has repeatedly emphasized, the Due Process Clause is vitally important in the forfeiture context. *See, e.g.*, *Jones v. Flowers*, 547 U.S. 220 (2006); *United States v. James Daniel Good Real Prop.*, 510 U.S. 43, 52, 62 (1993); *see also One 1958 Plymouth Sedan v. Pennsylvania*, 380 U.S. 693, 700 (1965) ("forfeiture proceeding is quasi-criminal in character").

Furthermore, *MDC 12* had specifically mandated that Contractors' challenge to the default termination be litigated under the *Lisbon-MDC 12* rule. Accordingly, *MDC 14*'s failure to remand after announcing its new approach was particularly egregious. Because Contractors never had a meaningful opportunity to adduce evidence and argument made relevant by

MDC 14's new approach, that decision denied them due process of law. *See Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673, 677 (1930).

B. The Court of Appeals' Refusal to Remand Creates a Conflict with Other Circuits.

Consistent with this Court's decisions, many circuits have held that the Due Process Clause requires remand when an appellate court announces a new controlling rule, to permit a party to present its case under the new rule. The decision below therefore creates a conflict among the circuits on an important issue relating to the fundamental procedural fairness of litigation in the federal courts.

Thus, in *Hatch v. FERC*, after the parties litigated before the ALJ under one standard, the Federal Energy Regulatory Commission on appeal denied petitioner's claim by "adopt[ing] a stricter interpretation of [the relevant statutory provision] than had heretofore prevailed." 654 F.2d 825, 830 (D.C. Cir. 1981). The D.C. Circuit observed that "when . . . the change [in the controlling standard] is a qualitative one in the nature of the burden of proof so that additional facts of a different kind may now be relevant for the first time, litigants must have a meaningful opportunity to submit conforming proof." *Id.* at 835. The court accordingly ruled that due process required the Commission to allow the petitioner "to submit any

additional relevant evidence . . . he may have in order to meet the new standard." *Id.* at 837.

Similarly, in *Harlan Bell Coal Co. v. Lemar*, an employer initially submitted to the ALJ sufficient evidence to defeat an employee's benefits claim under the then-controlling standard. 904 F.2d 1042, 1044 (6th Cir. 1990). After the ALJ had closed the record, however, the Sixth Circuit reinterpreted that standard in another case. *Id.* at 1044-45. On appeal the Board applied the new standard to the extant record, finding the employer's evidence inadequate. *Id.* at 1045. The Sixth Circuit reversed because the employer had "been effectively deprived of the opportunity to rebut evidence now supporting issues that did not exist at the time of its ALJ hearing." *Id.* at 1049. Explaining that the employer's "right to a hearing encompasses not only the right to present evidence, but also the right to rebut the [employee's] claims . . . under the correct legal standards," the court ruled that "due process considerations" required that the employer "must be granted an opportunity to present evidence directed at the [newly adopted] standards as such evidence is necessary to the full presentation of [the employer's] defense." *Id.*; *see also, e.g.*, *Peabody Coal Co. v. Ferguson*, 140 F.3d 634, 637 (6th Cir. 1998); *Singh v. INS*, 213 F.3d 1050, 1054 (9th Cir. 2000); *Millipore Corp. v. Travelers Indem. Co.*, 115 F.3d 21, 33-34 (1st Cir. 1997); *Marx v. Director, OWCP*, 870 F.2d 114, 121 (3d Cir. 1989); *Brinley v. Commissioner, IRS*, 782 F.2d 1326, 1336 (5th Cir.

1986); *Aero Mayflower Transit Co. v. ICC*, 699 F.2d 938, 942 (7th Cir. 1983).

C. The Federal Circuit's Immediate Application of Its New Test Prevents Contractors from Presenting Newly Relevant Argument and Evidence.

Relying on *MDC 12*'s clear mandate, Contractors maintained in the trial court and on appeal that default termination was improper because "the contract had no completion date for the 'entire contract effort' at termination, leaving no possibility that the contracting officer reasonably concluded the contractors would not complete the work on time." App. 234a, 242a-46a, 15a-16a. So clear was the *MDC 12* mandate that Contrac-tors had no reason to anticipate *MDC 14*'s adoption of a new, ad hoc approach closely resembling one *MDC 12* had *rejected*, let alone attempt to show that the Government could not meet its burden under that new approach. Nor could they reasonably have foreseen the need to proffer "record evidence to show . . . that they could have completed the contract on any date," or to argue on appeal "that their failure to make progress could be excused," App. 30a-31a, for these issues arise under the then-controlling *Lisbon-MDC 12* rule only if the Government first proves a binding date for completing the entire contract. Certainly Contractors could not have anticipated that the *Government*'s failure to carry *its* burden under *Lisbon-MDC 12* would require

Contractors to prove that they were making adequate progress toward a *nonexistent* completion date.

Had the Federal Circuit remanded the case after altering the governing standard, Contractors almost certainly would have prevailed. Instead, the appellate court drew its own factual conclusions out of a gargantuan record, making findings directly contrary to those of the trial court – seemingly, without even realizing that it had done so. In concluding that "the contracting officer was reasonably justified in *feeling insecure* about the Contractors' rate of progress," App. 29a (emphasis added), *MDC 14* relied on (1) Contractors' projected failure to meet the P00046 delivery schedule for the first eight test aircraft, (2) supposed concerns about Contractors' financial ability to perform the contract, and (3) Contractors' statements made while negotiating for an equitable contract restructuring and resisting unwarranted attempts to hold them to waived or superseded milestones and specifications. App. 25a-29a. Although the trial court had found, based on these matters, that Contractors might not have met *the interim milestones imposed by P00046*, that court had expressly disclaimed the conclusion that they endangered timely performance of *the entire contract*. *See, e.g.*, App. 206a, 212a-13a. On the contrary, that court found:

> • the contracting officer was "not particularly concerned" about the projected "failure to meet the [P00046] delivery schedule." App. 218a n.73;

- the Navy saw a projected nine-month delay in first flight as "realistic and acceptable," App. 181a n.44, 276a-77a n.11;

- Contractors' "financial condition was not endangering performance of the A-12 contract," App. 281a-82a;

- "[e]vidence at trial established that plaintiffs' financial ability was not a concern" of the contracting officer, App. 282a;

- "[t]he contractors' requests to restructure the contract were not declarations of financial inability or unwillingness to perform," App. 225a;

- the contracting officer "did not believe that the contractors would not perform," App. 283a;

- the senior Defense Department official spearheading the A-12 contract termination "had no concern that the contractors were incompetent or otherwise unable to handle the A-12 contract," App. 171a n.35; and

- the contractors "were committed to performing the A-12 contract until the date of termination," App. 227a.

These undisturbed findings, amply supported by the evidentiary record, alone appear to preclude a finding under *MDC 14* that "the contracting officer was reasonably justified in *feeling insecure* about the Contractors' rate of progress." App. 20a (emphasis added). Had they been afforded an opportunity on

remand, Contractors could have further negated any such conclusion by tailoring their arguments and evidence to the new, ad hoc approach. They could also have established both "that they were making progress such that timely completion of the contract was not endangered," and "that there was excusable delay," either of which would have provided a complete defense to default termination under *MDC 14*'s new approach. App. 30a.

While it is unclear what might constitute "timely completion" of the entire contract absent a valid completion date, Contractors could have proved that they would have met any reasonable completion schedule. In late 1990, Contractors and the Government had similar internal projections of the entire schedule leading to contract completion. JA 26,307; 92,112-13. These internal schedules, which were satisfactory to the Government, would have extended all milestones by roughly the same amount of time that P00046 had extended delivery milestones for the first eight test aircraft. *Id.* At termination, Contractors were on track to meet the later milestones these schedules projected. Indeed, the Navy itself estimated just before termination that the flight test program had a reserve of more than *40 aircraft months*, as long as first flight occurred by *the fourth quarter of 1992*, which was a conservative projection at the time of termination. JA 26,638; App. 178a n.44.[6] Further,

[6] The Federal Circuit noted that Contractors projected testing and evaluation to be completed 27 months after the original contract specified. App. 26a. The original testing-and-evaluation

(Continued on following page)

Contractors could have shown that the Government caused much of the delay early on by directing Contractors to focus on weight reduction rather than schedule compliance. App. 447a.

In short, Contractors almost certainly would have prevailed if given the opportunity to prove their case under *MDC 14*'s new ad hoc test. Bedrock principles of due process thus required the court to remand for further proceedings. Indeed, so glaring is the Federal Circuit's departure from fundamental canons of due process set forth in this Court's controlling precedents that summary reversal, with a remand to the trial court for further proceedings, may be warranted as an alternative to plenary review.

milestone did not, however, survive P00046's extension of the earlier milestones on which it depended, *cf.* App. 15a-16a, and Contractors' projection closely aligned with P00046, which extended by up to 25 months the delivery milestones for the first eight test airplanes. *See* JA 15,657. Had the parties believed the extra two-month delay was significant, Contractors easily could have compressed the lengthy contract testing period, as evidenced by the ample flight-test program reserve.

II. The Federal Circuit's Rule Permitting the Government to Prosecute a Claim While Asserting the State Secrets Privilege to Foreclose a Valid Defense to That Claim Violates Due Process and Conflicts with the Decisions of this Court and of Other Circuits.

Fundamental fairness does not permit the Government to assert a multi-billion-dollar claim against a defendant while refusing to disclose secret information that would defeat that claim. Here, the Government asserted a default termination claim and then invoked the state secrets privilege to bar Contractors from proving their *prima facie* valid superior knowledge defense to that claim. By allowing the default termination claim to proceed, *MDC 12* violated elemental due process and created a conflict with this Court's decisions and those of every other circuit that has addressed the issue.

Tellingly, the Government has *embraced* these due process principles when the shoe is on the other foot and it is attempting to defend against a claim. Indeed, earlier in this very case, the Government insisted that, if the court converted the termination for default to one for convenience, Contractors' claim for contractual payments should nonetheless be denied because a potential government defense to that claim would depend upon privileged state secrets. The Government argued: "As a matter of law, 'if the privilege deprives the *defendant* of information that would otherwise give the defendant a valid defense to

the claim, then the Court may grant summary judgment to the defendant.'" Def.'s Br. Regarding Effect of State Secrets and Mot. for Reconsideration 11 n.2 (Mar. 28, 2001) (quoting *Bareford v. General Dynamics Corp.*, 973 F.2d 1138, 1141 (5th Cir. 1992)); *see also* App. 373a-80a, 394-98a. The Government has repeatedly taken the same position in other cases. *See, e.g.*, *Al-Haramain Islamic Found., Inc. v. Bush*, 507 F.3d 1190, 1197 (9th Cir. 2007); *Hepting v. AT&T Corp.*, 439 F. Supp. 2d 974, 985-86 (N.D. Cal. 2006); *In re United States*, 872 F.2d 472, 477 (D.C. Cir. 1989); *Molerio v. FBI*, 749 F.2d 815, 819 (D.C. Cir. 1984).

This is exactly Contractors' position: their *prima facie* valid defense to the Government's default termination claim cannot be litigated because the Government asserted the state secrets privilege. Private parties defending against a Government claim are entitled to at least the same due process protections as the Government. Indeed, it is especially unfair to permit the Government to use the state secrets privilege both offensively and defensively in the same case, always to Contractors' disadvantage.

A. The Federal Circuit's State Secrets Analysis Deprives Defendants of Due Process in Conflict with This Court's Precedents.

Invoking this Court's decision in *United States v. Reynolds*, 345 U.S. 1 (1953), and circuit court decisions following it, the Federal Circuit ruled that

Contractors were precluded from asserting their superior knowledge defense to the Government's default termination claim because, "when a properly invoked claim of State Secrets privilege undercuts a civil litigant's opportunity to prove its case, the interests favoring protection of the state secret always prevail." App. 66a-69a, 71a. But Contractors did not dispute that genuine state secrets must always be protected; rather, they argued that permitting the privilege to preclude their *prima facie* valid defense *requires*, as a matter of due process, dismissal of the Government's default termination claim. The Due Process Clause will not permit the Government both to assert a claim and then to ensure its own victory by asserting the privilege to preclude its opponent from raising a valid defense.

In *Reynolds*, the plaintiffs sued the Government in tort and sought disclosure of a classified report withheld under the state secrets privilege. 345 U.S. at 3-5. Upholding the Government's assertion of privilege, the Court distinguished a criminal defendant from a civil plaintiff asserting a claim for monetary relief against the Government: "[I]n the criminal field, . . . the Government can invoke its evidentiary privileges only at the price of letting the defendant go free," for "it is unconscionable to allow [the Government] to undertake prosecution and then invoke its governmental privileges to deprive the accused of anything which might be material to his defense." *Id.* at 12. But this "rationale has no application," the Court held, "in a civil forum where the Government is

not the moving party, but is a defendant only on terms to which it has consented." *Id.*

Relying on this discussion in *Reynolds*, the Federal Circuit held that Contractors had "conflate[d] rules governing criminal and civil proceedings, elevating this civil contract dispute into the constitutional territory of a criminal prosecution." App. 69a. Concluding that "[t]he Contractors are not at jeopardy from an attack on them by the government," the court ruled that due process did not foreclose the Government from proceeding with its default termination claim, even as Contractors were barred from presenting their *prima facie* valid superior knowledge defense. App.70a.

In fact, however, this Court's decisions in *Reynolds* and other cases show that the Government's default termination claim here must be denied. Contrary to the Federal Circuit's decision, Contractors *are* at jeopardy – from a staggering multi-billion dollar forfeiture claim asserted against them by the Government – and due process entitles them to dismissal of that claim because the Government's invocation of the privilege bars them from raising a valid defense.

Reynolds did not specifically address the situation here, where the Government is the moving party asserting a *civil* penalty claim. But *Reynolds'* rationale concerning criminal defendants nonetheless plainly applies: just as in the criminal context, it is clearly unconscionable to allow the Government both to assert

a multi-billion dollar civil penalty claim against Contractors and also to "invoke its governmental privileges" to bar them from presenting a valid defense to that claim.[7]

Indeed, other decisions of this Court unambiguously hold that due process guarantees a civil defendant "an opportunity to present every available defense." *Lindsey v. Normet*, 405 U.S. 56, 66 (1972); *see also Logan*, 455 U.S. at 429. The underlying risk in civil and criminal cases involving the state secrets privilege is the same: if the Government can both assert a claim and invoke the privilege to bar a defense to that claim, it can distort the court's fact-finding process to its advantage. As this Court has explained, "[t]he purpose of an adversary hearing is to ensure the requisite neutrality that must inform all governmental decision-making. That protection is of particular importance here, where the Government

[7] Indeed, termination for default is a "species of forfeiture," *Decker & Co.*, 76 F.3d at 1580, and settled law holds that a "forfeiture proceeding is quasi-criminal in character." *One 1958 Plymouth Sedan*, 380 U.S. at 700 (applying the Fourth Amendment's exclusionary rule in forfeiture proceeding); *see also, e.g., Austin v. United States*, 509 U.S. 602 (1993) (finding that forfeiture constituted punishment for purposes of the Excessive Fines Clause of the Eighth Amendment); *Boyd v. United States*, 116 U.S. 616 (1886) (applying the Self Incrimination Clause of the Fifth Amendment in forfeiture proceeding) (*overruled in part on other grounds, Fisher v. United States*, 425 U.S. 391 (1976)). And default termination can have other quasi-criminal consequences as well, including debarment from public contracting. *See* FAR § 9.406-2(b)(1).

has a direct pecuniary interest in the outcome of the proceeding." *James Daniel*, 510 U.S. 55-56. The Federal Circuit's state secrets ruling thus violates due process and directly conflicts with this Court's clear precedents.

B. The Federal Circuit's State Secrets Analysis Conflicts with the Decisions of Other Circuits.

Consistent with this Court's civil due process precedents, "[m]ost courts that have discussed the state secret privilege have adopted the position that, if privileged information would establish a valid defense, then the court ought to dismiss the plaintiffs' case." *Bareford*, 973 F.2d at 1143 (citing *Zuckerbraun v. General Dynamics Corp.*, 935 F.2d 544, 547 (2d Cir. 1991), *In re United States*, 872 F.2d at 476, 481 (D.C. Cir. 1989), and *Molerio*, 749 F.2d at 821, 825).[8] In *Molerio*, for example, the plaintiff claimed that the FBI, its director, and its former personnel officer had illegally refused to hire him. 749 F.2d at 819. Then-Judge Scalia, writing for the court, held that two of the counts were "properly dismissed" because the

[8] Moved by similar concerns about fairness, courts have likewise not allowed civil plaintiffs to assert other types of privileges to foreclose a valid defense. *See, e.g., Ideal Elec. Sec. Co. v. International Fid. Ins. Co.*, 129 F.3d 143, 151-52 (D.C. Cir. 1997) (attorney-client privilege); *Lyons v. Johnson*, 415 F.2d 540, 542 (9th Cir. 1969) (Fifth Amendment privilege against self-incrimination).

Government's assertion of the state secrets privilege with respect to evidence of "the genuine reason for denial of employment" prevented the defendants from asserting a "valid[] . . . defense." *Id.* at 825-26. Indeed, other than the Federal Circuit here, all of the circuits addressing this issue have – often building on *Molerio* – made clear that a civil claim should be dismissed if the state secrets privilege forecloses a valid defense. *See also El-Masri v. United States*, 479 F.3d 296, 309 (4th Cir. 2007); *Tenenbaum v. Simonini*, 372 F.3d 776, 777 (6th Cir. 2004); *Kasza v. Browner*, 133 F.3d 1159, 1166 (9th Cir. 1998). The point of these cases is this: if the state secrets privilege requires a defendant to lay down its shield, due process requires the plaintiff to lay down its sword.

By embracing a contrary approach, the decision below creates a conflict among the circuits on an important question regarding the accommodation of fundamental due process concerns with the needs of national security. This Court's review is thus urgently needed to correct the decision below and restore clarity and uniformity in this critical area of the law.

III. The Federal Circuit's New Ad Hoc Rule for Default Terminations Will Destabilize An Important Area of the Law.

The Federal Circuit's new, ad hoc approach to default terminations is unworkable, unfair to contractors, and potentially very costly to the Government. It will have significant adverse consequences for the

Government's extensive contracting programs. *See* U.S. Government Accountability Office, GAO-09-326SP, *Defense Acquisitions: Assessments of Selected Weapon Programs* 4, 6 (Mar. 2, 2009) ["GAO Report"]. The Government's renewed emphasis on fixed-price contracts, which are directly governed by FAR § 52.249-9 (at issue here) and analogous default termination provisions, renders the Federal Circuit's novel interpretation especially momentous. *See, e.g.*, Barack Obama, *Memorandum for the Heads of Executive Departments and Agencies*, Mar. 4, 2009; Donna Miles, *Tanker Solicitation Seeks Fair Competition, Best Value*, American Forces Press Service, Feb. 24, 2010. Because the Federal Circuit has exclusive appellate jurisdiction of challenges to such terminations, the decision below effectively creates a national rule implicating all future government contracts of this kind. Clarifying the standard for terminating such contracts is thus an issue of exceptional importance that warrants this Court's attention.

Given the special rules that already apply in this area, the approach adopted below is unnecessary to protect the Government's interests and will create perverse incentives for arbitrary governmental action. Unlike a private party, the Government may terminate a contract for convenience at any time and for virtually any reason, without liability for breach, simply by paying for work already performed plus limited settlement costs. But if the Government terminates for default, it is not liable even for work the contractor already has performed. On the contrary,

this "drastic" remedy may entitle the Government "to the repayment of advance and progress payments" that have not been liquidated. *Decker & Co.*, 76 F.3d at 1580; FAR § 49.402-2. Absent bad faith, the only consequence to the Government if a court rules that the "default decision represented an abuse of discretion" is that termination is converted "into one for the convenience of the Government." *Darwin Constr. Co. v. United States*, 811 F.2d 593, 597 (Fed. Cir. 1987).

These rules incentivize the Government to terminate for default and take its chances in subsequent litigation. To temper the consequences of such a "drastic sanction," which effects a forfeiture of contractors' rights, courts have long insisted upon clear, strict standards to guard against arbitrary default terminations. *See, e.g.*, *De Vito v. United States*, 413 F.2d 1147, 1153 (Ct. Cl. 1969); *King v. United States*, 37 Ct. Cl. 428, 436 (1902).

Lisbon and *MDC 12* struck a "pragmatic," carefully calibrated "balance" between "the judicial aversion to default terminations" and the Government's right "to receive that for which it contracted" by adopting clear, fair rules for determining when schedule delays warrant the drastic sanction of default termination. App. 50a-51a. In complex contracts where delays are commonplace, *see* GAO Report 6, 10-11, the requirement that default termination be based on the contracting officer's reasonable belief that there is no reasonable likelihood that the contractors will perform "the entire contract effort" by the "contract

completion date" provides a rule that is both workable and fair.

Contrary to the court's assertions below, nothing about the lack of a valid contract completion date renders *Lisbon* "unworkable" or unsound. In fact, without clear guidance for *when* a contract must be completed, it is not only unreasonable, but also logically impossible to conclude that there is no reasonable likelihood of timely completion. App. 55a. Nor does the Government's inability to meet its burden under *Lisbon* without a valid completion date make that decision "difficult to apply." Indeed, the Boards of Contract Appeals – "whose specialized expertise with government contracts is entitled to respect," App. 52a-53a n.2 – have had no difficulty applying *Lisbon* to contracts lacking a "reasonable and specific completion date," repeatedly holding that in such circumstances "the Government could not rationally terminate for default for failure to make progress, since there was no objective against which the contractor's progress could be judged." *Divecon Servs., LP*, 04-2 BCA ¶32,656 at 161,634-35 (GSBCA 2004).[9]

[9] *See Technocratica*, 06-2 BCA ¶33,316 at 165,190 (ASBCA 2006); *AST Anlagen-Und Sanierungstechnik GmbH*, 04-1 BCA ¶32,558 at 161,043-44 (ASBCA 2004); *Upwest Corp.*, 01-2 BCA ¶31,474 at 155,393 (PSBCA 2001); *American Sheet Metal Corp.*, 99-1 BCA ¶30,329 at 149,994-95 (GSBCA 1999); *Technocratica*, 94-2 BCA ¶26,606 at 132,370 (ASBCA 1993); *Lanzen Fabricating, Inc.*, 93-3 BCA ¶26,079 at 129,609 (ASBCA 1993); *M.V.I. Precision Machining, Ltd.*, 91-2 BCA ¶23,898 at 119,741 (ASBCA 1991); *Motorola Computer Sys., Inc.*, 87-3 BCA ¶20,032 at 101,416 (ASBCA 1987).

Applying *Lisbon* in this way does not disadvantage the Government. Unlike a private party, the Government always possesses the power *unilaterally to impose* a reasonable completion date against which to measure a contractor's progress. App. 60a. Requiring the Government to impose a clear completion date before penalizing a contractor for failing to make progress toward timely completion is just what basic fairness requires. Furthermore, courts have recognized a narrow exception to the requirement for a completion date in the exceptional case, unlike this one, where a contractor is "making no progress at all," and the evidence shows that progress will never resume. *Universal Fiberglass Corp. v. United States*, 537 F.2d 393, 397 (Ct. Cl. 1976). These rules, as well as the government-friendly rules governing default and convenience terminations discussed above, more than suffice to protect the Government's legitimate interests.

Unlike *Lisbon*, it is the ad hoc approach ordered by the court below that is unworkable and unfair. At best, the new approach is arbitrary and unpredictable, turning on any conceivable subjective circumstance, apparently including failure to meet milestones and specifications that the Government previously waived. *Compare* App. 25a-27a, *with* App. 60a-61a. At worst, the new approach is circular and incoherent, requiring an ungrounded prediction of whether "timely" performance is endangered, despite the absence of an enforceable completion date.

By replacing the *Lisbon* test with this flawed ad hoc approach, the decision below will increase the

Government's already substantial incentive to default terminate, regardless of whether that remedy is justified. Moreover, the new approach reverses the Government's incentive to forthrightly reset waived or superseded schedules: while the Government cannot prevail under *Lisbon* absent a valid completion date (unless the contractor is making no progress whatsoever), the new approach holds the Government to a less-demanding standard when there is no contract completion date than when there is one. Without a definite deadline, contractors will be unable to know whether their progress is adequate, and courts will lack an objective basis for judging the reasonableness of a Government claim that it *"feel[s] insecure* about the contractors' rate of progress." App. 24a-31a (emphasis added).

The result will be an inevitable decrease in predictability, with a concomitant increase in unwarranted default terminations and litigation disputing them. And while the ruling below will inure to the Government's benefit here, over time it will most likely harm the Government, as contractors either refuse to enter fixed-price contracts or demand a premium to compensate for the heightened risk of arbitrary or unjustified forfeitures. *See United States v. Winstar Corp.*, 518 U.S. 839, 913 (1996) (Breyer, J., concurring).

Contrary to the Federal Circuit's suggestion, *see* App. 35a-36a, its decision will not be limited to the facts of this case or rare cases. Schedule waivers and realignments are typical of Government contracts, especially complex R&D contracts such as this one.

And default terminations of contracts lacking a valid completion date are not particularly unusual, either, as indicated by the numerous Boards of Contract Appeals cases cited above. Further, the frequency of such default terminations undoubtedly will increase now that the Government's incentive to re-establish a valid completion schedule has been replaced with an incentive to leave the completion date undefined.

♦

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted. As an alternative to plenary review, this Court may wish to consider summarily reversing the judgment below, with instructions to remand the case to the trial court to afford Contractors an opportunity to satisfy the Federal Circuit's new test for reviewing a default termination.

April 23, 2010

Respectfully submitted,

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MCDONNELL DOUGLAS CORPORATION, Plaintiff-Appellant, and GENERAL DYNAMICS CORPORATION, Plaintiff-Appellant, v. UNITED STATES, Defendant-Appellee.

2007-5111, 2007-5131

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

567 F.3d 1340; 2009 U.S. App. LEXIS 11716

June 2, 2009, Decided

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JUDGES: Before MICHEL, Chief Judge, MOORE, Circuit Judge, and HUFF,* District Judge.

OPINION BY: MICHEL

OPINION

MICHEL, *Chief Judge*.

This case arises from the government's default termination in 1991 of a contract between the United States Navy ("the government") and two contractors, McDonnell Douglas Corporation ("MDC") and General Dynamics Corporation ("GD") (collectively "contractors") to develop a carrier-based stealth aircraft, the A-12 Avenger. The contractors challenge the

* Honorable Marilyn L. Huff, District Judge, United States District Court for the Southern District of California, sitting by designation.

judgment of the Court of Federal Claims in favor of the government. *McDonnell Douglas Corp. v. United States,* 76 Fed. Cl. 385 (2007) ("*McDonnell Douglas XIII*"). We heard oral argument on December 3, 2008. Because the overall evidence of record supports a conclusion that the government was justified in terminating the contract for default, we affirm.

I. BACKGROUND

This American version of *Jarndyce and Jarndyce* has entered its eighteenth year of litigation. The detailed facts have been repeated many times previously. *See, e.g., McDonnell Douglas XIII*; *McDonnell Douglas Corp. v. United States,* 323 F.3d 1006 (Fed. Cir. 2003) ("*McDonnell Douglas XII*"); *McDonnell Douglas Corp. v. United States,* 50 Fed. Cl. 311 (2001) ("*McDonnell Douglas XI*"); and *McDonnell Douglas Corp. v. United States,* 182 F.3d 1319 (Fed. Cir. 1999) ("*McDonnell Douglas X*"). As we are writing what necessarily will become "*McDonnell Douglas XIV,*" we will only provide a summary of relevant facts here.

A. *The A-12 contract*

In January 1988, the Navy awarded the contractors a fixed-price research and development contract for the A-12 stealth aircraft. The full-scale engineering and development ("FSD") contract was structured as an incrementally funded, fixed-price incentive contract with a ceiling price of $4,777,330,294. The contract incorporated by reference Federal Acquisition

Regulation (FAR) 52.249-9 Default provision (Fixed-Price Research and Development), which provides in relevant part:

> (a)(1) The Government may . . . by written Notice of Default to the Contractor, terminate this contract in whole or in part if the Contractor fails to –
>
> . . .
>
> (ii) Prosecute the work so as to endanger performance of this contract (but see paragraph (a)(2) of this clause);
>
> . . .
>
> (2) The Government's right to terminate this contract under subdivisions (a)(1)(ii) and (iii) of this clause may be exercised if the Contractor does not cure such failure within 10 days (or more, if authorized in writing by the Contracting Officer) after receipt of the notice from the Contracting Officer specifying the failure.

48 C.F.R. § 52.249-9 (1984).

Under the contract, the contractors were to design, manufacture, and test eight A-12 prototypes according to a specified schedule, with the first aircraft to be delivered in June 1990 (the "first flight" date) and the remaining seven to be delivered monthly through January 1991. The contractors were to conclude their testing of the aircraft by April 1993, the completion time of the Navy's technical evaluation program ("TCHEVAL"). The contractors would also

support the Navy's evaluation of the aircraft and further provide training support for three years after delivering training equipment to the Navy in June 1993. In addition, the contract gave the Navy the option to purchase four production lots of aircraft. In May 1990, the Navy exercised its option on Lot I for six aircraft to be delivered between June 1991 and May 1992.

B. *Modification of the A-12 contract*

From the start, the contractors encountered difficulties in performing the contract, including meeting the contract schedule and keeping the aircraft weight within specifications. *McDonnell Douglas XII,* 323 F.3d at 1011. Two weeks before the first flight date, the contractors reported to the Navy that the projected first flight date would be July-September 1991, instead of June 1990 as originally agreed, and the remainder of the contract work would be delayed a corresponding twelve to fourteen months. They also predicted that the cost of completing the contract would exceed the ceiling price so substantially that it would be "unacceptable" to the contractors. The contractors asserted that a fundamental problem with the FSD contract was its fixed-price structure and proposed that the contract be modified.

At the end of June 1990, the contractors missed the first flight date. The Navy did not terminate the contract. Instead, the contracting officer sent a letter to the contractors in July, expressing "serious

concern" regarding the deficient performance under the contract. He warned that the contractors' failure to meet the first flight date "could jeopardize performance of the entire [contract] effort." He also asked for the contractors' plan to meet the rest of the original schedule as well as their proposal for contract revision.

As the parties failed to reach an agreement, on August 17, 1990, the Navy unilaterally issued a contract modification, P00046, which revised the prototype aircraft delivery dates but left Lot I and later milestones intact. The delivery schedules are:

	Aircraft Number	Original Delivery Date	P00046 Modified Delivery Date
Prototype	1	June 1990	December 1991
	2	July 1990	February 1992
	3	August 1990	June 1992
	4	September 1990	August 1992
	5	October 1990	September 1992
	6	November 1990	November 1992
	7	December 1990	December 1992
	8	January 1991	February 1993
Lot I	9	June 1991	
	10	August 1991	
	11	October 1991	
	12	December 1991	
	13	March 1992	
	14	May 1992	

C. *Performance after contract modification*

After the contract modification, more problems arose concerning the performance of the contract. During the months leading to termination, the contractors' internal schedules showed that they would not meet the P00046 modified first flight date in December 1991. *McDonnell Douglas XIII,* 76 Fed. Cl. at 401. Instead, they projected three more months' delay with the first flight date in March 1992. By December 1990, the contractors' "confidence in the March 1992 flight date [was further] reduced." They believed that such a date was achievable "only after significant changes."

At the same time, the contractors continued operations, spending $120-150 million of their own money every month. *McDonnell Douglas XIII,* 76 Fed. Cl. at 427. In November 1990, the contractors submitted a formal request to the Navy to restructure the contract as a cost-reimbursement type contract. *McDonnell Douglas X,* 182 F.3d at 1322.

D. *The termination*

The contractors' continued difficulties in performing the contract led the Department of Defense and the Navy to question the viability of the project. On Friday, December 14, 1990, then-Secretary of Defense Dick Cheney directed the Secretary of the Navy to show cause by January 4, 1991, why the A-12 program should not be terminated.

The following Monday, December 17, the Navy issued a cure notice to the contractors, stating that the government considered the contractors' performance under the contract "unsatisfactory." In particular, the cure notice stated that the contractors had "failed to fabricate parts sufficient to permit final assembly in time to meet the schedule for delivery," and had "failed to meet specification requirements." The letter asserted that "these conditions [were] endangering performance of [the] contract," and that unless these conditions were cured by January 2, 1991, the government might terminate the contract for default.

In the following days, high-level meetings occurred between the responsible government personnel and the contractors. *McDonnell Douglas X,* 182 F.3d at 1323. During these meetings, the contractors asserted that they could not "get there if [they didn't] change the contract," and that it "got to get reformed to a cost type contract or [they could not] do it." When asked by the government if they could "correct deficiencies to provide an aircraft that meets the requirements," the contractors replied that "all deficiencies cannot be corrected. . . . Mother [N]ature won't allow correction of all defects. We'll do the best we can and the Navy has to decide if that's good enough."

On January 2, 1991, in responding to the cure notice, the contractors admitted that they would "not meet delivery schedules or certain specifications of the original contract, or the revised FSD delivery schedule." However, they denied that they were in

default because, in their view, the delivery schedules were invalid. They asserted that "the fundamental factual assumptions of the original contract, with respect to schedule and achievability of certain specification requirements, were gravely mistaken," and therefore, "the schedules and certain other specification requirements, such as weight, were impossible to satisfy." The contractors concluded that "[i]n these circumstances, there [was] not an enforceable schedule or specifications against which to measure their performance." They further declared that compliance with the government's demand to cure by January 2, 1991 was "unachievable."

However, the contractors stated that they were "fully committed to the success of the [A-12] Program." They again submitted their proposal to restructure the contract to a cost reimbursement contract. In exchange for that restructuring, the contractors would absorb a $1.5 billion fixed loss and would waive their claims for equitable adjustment.

On January 7, 1991, Rear Admiral William Morris, the contracting officer at the time, issued a termination letter to the contractors stating that the government was terminating the A-12 contract due to the contractors' default. A few weeks later, the Navy sent a letter to the contractors demanding the return of approximately $1.35 billion in unliquidated progress payments under the terminated contract. *McDonnell Douglas X*, 182 F.3d at 1324.

II. LITIGATION HISTORY

A. *The first round*

In June 1991, the contractors sought relief in the Court of Federal Claims under the Contract Disputes Act, 41 U.S.C. § 609(a), requesting that the court: (1) grant the contractors' equitable adjustment claims, (2) convert the government's termination for default into a termination for convenience, (3) deny the government's demand for return of progress payments, (4) award the contractors costs and a reasonable profit under the contract, (5) award the contractors settlement expenses, and (6) award damages for breach of contract.

After several years of litigation, the Court of Federal Claims ruled that the government's default termination was invalid. *McDonnell Douglas Corp. v. United States,* 35 Fed. Cl. 358, 368-71 (1996) ("*McDonnell Douglas IV*"). It found that the contracting officer failed to exercise "reasoned discretion" before the default termination because Secretary Cheney's actions effectively forced the Navy to terminate the A-12 contract for default. *Id.* at 369-71. Therefore, it vacated the government's termination for default and converted it into a termination for convenience. *Id.* at 361. The court ultimately denied the government's claim for return of $1.35 billion in unliquidated progress payments, and entered judgment of approximately $1.2 billion in favor of the contractors. *McDonnell Douglas Corp. v. United*

States, 40 Fed. Cl. 529, 555-56 (1998) ("*McDonnell Douglas IX*").

On appeal, we reversed, holding that because the termination for default was related to the contractors' performance, it was within the discretion of the government. *McDonnell Douglas X,* 182 F.3d at 1321. We remanded the case for the trial court to determine whether the default termination was justified. *Id.*

B. *The second round*

After a six-week trial on remand, the Court of Federal Claims ruled in favor of the government. *McDonnell Douglas XI,* 50 Fed. Cl. at 319. The court sustained the default termination based solely on the contractors' failure to meet the December 1991 first flight date. *Id.* at 315-19. It declined to base its determination of justified default on the contractors' alleged financial inability to perform the contract, anticipatory repudiation, and failure to comply with weight and other specification requirements. *Id.* at 319-24. The court also rejected the contractors' arguments that the unilateral schedule was unreasonable and therefore unenforceable, or, if enforceable then the Navy waived the unilateral schedule and first flight date of December 1991; that the contract was commercially impossible to perform; and that the Navy had to disclose its alleged superior knowledge despite the assertion of the state secrets privilege. *Id.* at 324-26. The court then entered judgment in favor of the government. *Id.* at 326.

On appeal, we affirmed the trial court's determination that the unilateral schedule imposed by the government was enforceable and not waived, that the Military and State Secrets privilege precluded litigation of the contractors' "superior knowledge" claim, and that the government's claim for progress payments was not at issue in the case. *McDonnell Douglas XII*, 323 F.3d at 1018-24. However, we held that the trial court misapplied the controlling standard in determining whether the default termination was justified. *Id.* at 1012-14. Therefore, we again vacated and remanded. *Id.*

Specifically, we stated that a default termination did not require "absolute impossibility of performance or a contractor's complete repudiation or abandonment." *Id.* at 1015. On the other hand, the government cannot justify a default termination "based solely on a contractor's concerns about meeting a contractual schedule milestone or specification requirements." *Id.* Instead, the government must establish by a preponderance of the evidence of a "reasonable belief on the part of the contracting officer that there was no reasonable likelihood that the contractor could perform the entire contract effort within the time remaining for contract performance." *Id.* at 1016. (citing *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759, 765 (Fed. Cir. 1987)).

C. *The third round*

On remand, the Court of Federal Claims stated as follows:

> The case turns on whether the Circuit's remand meant for the clauses, "entire contract effort" and "contract completion date" to mean exactly what they appear to mean – the contractors' expansive view; or whether the remand permits our use of a more compact yardstick – coinciding with the Government's restricted view. The Government did not establish a contract closing date and the contracting officer did not conduct a *Lisbon* analysis prior to termination.

McDonnell Douglas XIII, 76 Fed. Cl. at 437 n.92. The court concluded that the government could not "prevail if the law require[d] an enforceable contract completion date at termination," but went on to state that the government's "burden of proof [did] not necessarily require the Government to provide a completion date for the entire contract effort." *Id.* at 388.

Based on its understanding that we "implied in this case that a court may choose a reasonable period of performance to use as a measure of progress on the contract," *id.* at 420, the court found that the Navy's unilateral modification, P00046, was a yardstick that "enable[d] the court to consider the contractors' progress in light of factors that are probative of their ability and willingness to perform," *id.* at 389. Using P00046 as the yardstick and considering "all of the

relevant facts and testimony," *id.* at 421, including mitigating factors for the contractors, the court concluded that the overall evidence of record supported a conclusion that the government was justified in terminating the contract for failure to make progress, *id.* at 430.

In addition, the trial court stated that the judgment in the case mooted the government's alternative argument that the contractors did not provide adequate assurances to the contracting officer after receiving the notice to cure. *Id.* at 434.

The contractors timely appealed. We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3).

III. DISCUSSION

A. *Standard of review*

Whether the government is justified in terminating a contract for default is a question of law based on factual underpinnings. *McDonnell Douglas X*, 182 F.3d at 1325. We review issues of law de novo, without deference to the trial court. *McDonnell Douglas XII*, 323 F.3d at 1012 (citation omitted). However, we will not disturb the trial court's factual findings, such as its evaluation of evidence of default, unless they are clearly erroneous. *Id.*

B. *Analysis*

1. *Termination for failure to make progress in the absence of a contract completion date*

In *McDonnell Douglas XII,* we quoted the language from *Lisbon in toto* and directed the Court of Federal Claims to determine "the performance required by the contract[1] and *the contract completion date.*" 323 F.3d at 1018 (emphasis added, footnote added). We acknowledge that this specific instruction, if read literally, turns out to be difficult to apply. This is largely due to the unique facts of this case and the disadvantage we faced last time when deciding the case without the benefit of sufficient fact findings from the trial court. *See id.* at 1014.

The difficulty in strictly applying the *Lisbon* test lies in the critical fact that P00046 revised the prototype aircraft delivery dates but left Lot I delivery

[1] Generally, obligations arising from the exercise of an option are part of a new contract only when the option was the principal subject matter of the bargain, i.e., an option contract. *Alliant Techsystems, Inc. v. United States,* 178 F.3d 1260, 1275 (Fed. Cir. 1999) (citing 3 Eric Mills Holmes, *Corbin on Contracts* § 11.1 (1996)). In this case, because the option to purchase Lot I production aircraft is not the principal subject matter of the original bargain, it is properly considered as part of the original A-12 contract between the contractors and the government. Thus, "the performance required by the contract" includes the design, manufacturing, and testing of the eight prototype planes under the FSD contract, the manufacturing and testing of the six Lot I production aircraft, and other testing and supporting of the project.

dates unchanged. As such, there is an overlap between the modified delivery schedule for the eight prototype aircraft and the original delivery schedule for the Lot I production aircraft. *See* Delivery Schedules, *supra*. The government insists that the Lot I schedule remains in effect because that portion of the original contract was not modified by P00046. However, "[t]he A-12 contract was designed as a long-term research and development effort, structured so that each period of performance built upon preceding work." *McDonnell Douglas XIII*, 76 Fed. Cl. at 432. Because the eighth test plane would serve as the prototype for the Lot I aircraft, the contractors could not have delivered Lot I aircraft according to the original schedule as that would require delivering the production aircraft prior to the prototype planes. Therefore, we agree with the Court of Federal Claims that the "[a]pplication of the contract in [the] manner [advocated by the government] would be nonsensical." *McDonnell Douglas XIII*, 76 Fed. Cl. at 432. It follows that the contract, as modified by P00046, does not provide a definite contract completion date.[2] *Id.* at 401.

[2] The contractors offered legal principles, such as judicial estoppel and waiver, to support this point. We do not believe it is necessary to reach those arguments. Whether the contract has a completion date is a question of fact. Common sense in this case dictates the conclusion that "[t]he overlapping schedule offered by the Government as a basis for assessing default is unreasonable and likely unenforceable." *McDonnell Douglas XIII*, 76 Fed. Cl. at 432.

The contractors would have us apply the *Lisbon* test literally and hold that the absence of a contract completion date *per se* precludes the government from ever justifiably terminating a contract for failure to make progress. We cannot adopt such a broad categorical rule. The propriety of such a default termination, even though ultimately a question of law, is a fact-sensitive inquiry. The *Lisbon* test requires the contracting officer's *reasonable* belief that there was no *reasonable* likelihood of timely completion. *Lisbon,* 828 F.2d at 765. Therefore, it is inevitable that some case-by-case adjudication is required.

To be sure, just as the prior panel did, we reaffirm that the test formulated in *Lisbon* is a correct standard for determining whether a default termination for failure to make progress is justified. However, this test was announced in view of the specific facts presented in that case, where there was a definite contract completion date. *Lisbon,* 828 F.2d at 761, 762. It did not address the situation where, as in the present case, the contract does not specify a fixed completion date. *See United States v. Alaska S.S. Co.,* 253 U.S. 113, 116, 40 S.Ct. 448, 64 L.Ed. 808 (1920) (stating that a court "will determine only actual matters in controversy essential to the decision of the particular case before it," and that it "is not empowered to decide . . . abstract propositions . . . which cannot affect the result as to the thing in issue in the case before it"). As such, the *Lisbon* standard could not be literally applied in every default termination for failure to make progress case.

We are confident that *Lisbon* does not, as the contractors argue, foreclose a court's review of a default termination for failure to make progress merely because of an unascertainable contract completion date. This is evident from *Lisbon* itself, in which the court approved the Claims Court's citation and interpretation of *Universal Fiberglass Corp. v. United States,* 210 Ct. Cl. 206, 537 F.2d 393, 397 (1976).[3] *Lisbon,* 828 F.2d at 765.

Universal Fiberglass involved a supply and service contract for more than 12,000 mail delivery trucks. 537 F.2d at 394. The contractor in that case repeatedly failed to meet the installment delivery schedule, even after several extensions of time. *Id.* at 394-95. It closed down almost all of the production lines and laid off most of its labor force. *Id.* at 395. Meanwhile, a government audit showed that the contractor was insolvent. *Id.* Time and again, the government asked the contractor to furnish its proposed revised delivery schedule, but to no avail. *Id.* The government issued a Preliminary Notice of Default and gave the contractor ten days to cure all of its defaults. *Id.* at 396. After the contractors waived its rights to the full ten-day notice period, the government promptly terminated the contract for failure to make progress. *Id.*

[3] *Universal Fiberglass* was also cited with approval by the previous two panels in deciding the present case. *See McDonnell Douglas X,* 182 F.3d at 1328; *McDonnell Douglas XII,* 323 F.3d at 1015.

The Court of Claims held that the contract was properly terminated for failure to make progress. *Id.* The court found that in the absence of a delivery schedule, i.e., the contract completion date, the "cure notice" served the purpose of advising the contractor when the time for default has been reached. *Id.* at 398. The court reasoned:

> The contractor had already been asked to submit a new delivery schedule and had not done so. Nor had the contracting officer learned, from the contractor or any other source, any information to lead him to believe that deliveries would or could ever be resumed. In such circumstances, a unilateral delivery schedule prescribed by him would have been an exercise in futility, except for forensic purposes, should we be so foolish as to give the absence of such a schedule any legal significance or weight.

Id.

We realize that the facts in *Universal Fiberglass* are not exactly the same as in the present case. First, the difficulties in designing and manufacturing stealth aircraft are incomparable to those in making small three-wheeled mail delivery trucks. More importantly, as the contractors correctly point out, in *Universal Fiberglass,* the contractor "was making no progress at all, had never manufactured a vehicle under the new specifications it had agreed to, did not have the necessary parts and could not obtain them and had allowed its labor force to wither away." *Id.* at

398. In contrast, in the present case, "[d]espite delays, the contractors continued operations. They were spending $120 to $150 million of their own money every month. They were committed to performing the A-12 contract until the date of termination." *McDonnell Douglas XIII,* 76 Fed. Cl. at 427.

However, the contractors' commitment to performing the contract was not without conditions. Starting from as early as June 1990, the contractors had asserted that "the A-12 contractual schedule [was] not achievable and need[ed] to be changed." They also predicted that the cost of completing the contract would exceed the ceiling price so substantially that it would be "unacceptable" to the contractors. Insisting that the A-12 project could not "be accomplished under a fixed price type contract without [solving] the financial, schedule and specification problems," the contractors proposed that the contract be modified. The contractors maintained this position throughout their performance of the A-12 contract.

After missing the original first flight date, "[t]he contractors were working to an aggressive schedule, but they would not sign up for one." *McDonnell Douglas XIII,* 76 Fed. Cl. at 399. Because the contractors rejected the government's proposal of a bilateral modification of the contract, the government imposed the unilateral modification of the delivery schedule for the prototype airplanes, P00046, "as a first step in achieving the overall delivery schedule." *McDonnell Douglas XIII,* 76 Fed. Cl. at 400.

P00046 extended the first flight date from June 1990 to December 1991. The contractors' projected delivery date, however, further slipped away. "Six months prior to termination, the contractors projected a twelve to fourteen-month delay in first flight [June-August 1991]. By termination, the contractors' expectations extended first flight to March 1992." *McDonnell Douglas XIII,* 76 Fed. Cl. at 422. In fact, by December 1990, the contractors' confidence in even the March 1992 flight date was reduced. They believed that such a date was achievable "only after significant changes." As the trial court found, "Navy officials . . . could not predict when the contractors would deliver first flight." *McDonnell Douglas XIII,* 76 Fed. Cl. at 401.

As the contractors themselves emphasize, "one cannot test an aircraft before it has been built, nor build a production airplane before developing its prototype." Therefore, without the timely delivery of the prototype airplanes, there would be no basis for the government to prescribe a new delivery schedule for Lot I aircraft. In this sense, similar to the Court of Claim's opinion in *Universal Fiberglass,* we believe requiring the contracting officer to artificially reset the contract completion date would have been "supererogatory," "except for forensic purposes." *See Universal Fiberglass,* 210 Ct. Cl. at 217, 537 F.2d 393. Therefore, we agree with the trial court that this case is similar to *Universal Fiberglass* in that

> a schedule is not necessary because the cure notice supplants the schedule and

> serves a similar function. The cure notice lets a contractor know that even if performance or delivery is not yet due, the contracting officer believes the contractor may not be making sufficient progress to complete the contract on time. The burden is then on the contractor to advise the Government how it will complete the project on time, according to contract requirements.

Id. at 419.

One could analogize the *per se* rule advocated by the contractors to an injunction against the government. In granting or denying an injunction, a court follows traditional equitable principles and "balances the conveniences of the parties and possible injuries to them" to arrive at a "nice adjustment and reconciliation" between the competing claims. *Weinberger v. Romero-Barcelo,* 456 U.S. 305, 312, 102 S.Ct. 1798, 72 L.Ed.2d 91 (1982). When a government contract is terminated, there are two interests at issue – the contractor's interest in holding the government to its obligation to carry out the contract, and the government's interest in not wasting taxpayer dollars. The contractors in this case, however, would have us enjoin the government from ever terminating a contract for failure to make progress based on a single factor – the contract lacks a set completion date. We reject such a *per se* rule because it serves only the contractors' interest. Instead, we favor an ad hoc, factual inquiry that allows careful examination and weighing of all relevant circumstances. *See McDonnell Douglas*

XII, 323 F.3d at 1014 (stating that "[i]n determining whether a default termination was justified, a court must review the evidence and circumstances surrounding the termination, and that assessment involves a consideration of factual and evidentiary issues").

In fact, in our 2003 opinion, we provided the same guidance, stating that to determine whether a default termination is justified, "the trial court should focus on the events, actions, and communications leading to the default decision in ascertaining whether the contracting officer had a reasonable belief that there was no reasonable likelihood of timely completion." *McDonnell Douglas XII,* 323 F.3d at 1017. Of course, in some cases, it is possible that a conclusion drawn from a comparison of the entire contract effort and the time remaining for contract performance is so clear that it becomes dispositive. *See Lisbon,* 828 F.2d at 765. However, in cases such as the present one, where such a comparison is inapplicable, the court must examine other factors, including the contractor's failure to meet progress milestones, its problems with subcontractors and suppliers, its financial situation, and its performance history. *See McDonnell Douglas XII,* 323 F.3d at 1017. Only after analyzing the totality of the circumstances can a court determine whether a contractor failed to "[p]rosecute the work so as to endanger performance" of the contract. *See* 48 C.F.R. § 52.249-9.

2. *Default termination of the A-12 contract*

It is true that the A-12 contract, as modified by P00046, lacks a definite contract completion date. However, this single factor, even though important, is insufficient to support the contractors' contention that the government cannot sustain the default termination. A court must also take into account other relevant facts and testimony in deciding whether the default termination was justified.

In *Lisbon,* we held that the government bears the burden of justifying the propriety of a default termination. 828 F.2d at 765. We also stated that "the contracting officer's termination decision [must] be based on tangible, direct evidence reflecting the impairment of timely completion." *McDonnell Douglas XII,* 323 F.3d at 1016 (citing *Lisbon,* 828 F.2d at 766). The direct evidence includes the contractors' "statements that they could not meet the contract specifications, the contract delivery schedule, nor complete performance at the specified contract price." *Id.* at 1013 (quoting *McDonnell Douglas X,* 182 F.3d at 1332). The direct evidence also includes the "contracting officer's testimony and contemporaneous documents." *Id.* at 1016. The Court of Federal Claims made detailed factual findings based on the evidence. *McDonnell Douglas XIII,* 76 Fed. Cl. at 422-30. After reviewing the record, we see no clear error. Therefore, we only highlight a few important aspects here.

a. *Contractors' performance history and failure to meet progress milestones*

The contractors missed several milestones under the original contract, the most significant of which, of course, is the June 1990 first flight date. They also missed the July 1990 delivery date for the second prototype airplane. More tellingly, after the government unilaterally modified the contract through P00046, and in fact, in their response to the cure notice, the contractors unequivocally stated that they would not meet the revised delivery schedule for the eight prototype airplanes. Instead, they projected that the first flight date would be in March 1992, three months after the date imposed in P00046. By December 1990, the contractors were only "50%" confident in this date, believing it was achievable "only after significant changes."

The contractors and the *amicus curiae* argue that if we uphold the default termination here, the government may terminate for failure to make progress a contract for any minor slippage in meeting any insignificant interim milestone. This is an exaggeration. First of all, due to the sequential "building block" structure of the A-12 contract, delivery of the prototype airplanes is not just any milestone. It is certainly not an insignificant milestone. Quite to the contrary, it is clearly one of the most important milestones in the entire contract. This is because, as the contractors admit, "one cannot test an aircraft before it has been built, nor build a production airplane before developing its prototype."

Second, the delay in the delivery schedule is hardly just a minor slippage. The A-12 contract provided the June 1990 first flight date. In other words, it provided the contractors thirty months from the contract award time (January 1988) to deliver the first prototype plane. P00046, in extending the first flight date to December 1991, gave the contractors 60 percent more time to reach this significant milestone. Yet, the contractors, even though at first predicting that they would, concluded that they could not meet this schedule. In fact, they were not even sure if they could deliver in March 1992. According to the contractors' own estimate, even assuming they could meet the March 1992 first flight date, they would not complete the design, manufacturing, and testing of the aircraft until July 1995, two years and three months after the April 1993 TCHEVAL deadline specified in the original contract.

More importantly, we are not upholding the default termination "based solely on a contractor's concerns about meeting a contractual schedule milestone." *McDonnell Douglas XII*, 323 F.3d at 1015 (citing *Lisbon*, 828 F.2d at 765). As we explained above, the contractors' failure to meet progress milestones is one factor to be considered in the totality-of-the-circumstances analysis. In this respect, we agree with the trial court that

> [m]issed milestones "indicate a pattern of nonperformance and delay which should not be ignored. Although not justifications for default in themselves, they provide a

> context for understanding and evaluating plaintiff's continued problems." Such information should be relevant if we consider whether a reasonable contracting officer might reasonably have been concerned about [the contractors'] ability to complete the contract on time.

McDonnell Douglas XIII, 76 Fed. Cl. at 426 (quoting *Universal Fiberglass,* 537 F.2d at 397).

b. *Contractors' financial situation*

Another piece of relevant information we consider when reviewing a default termination is the contractors' financial situation. "The cost to complete a contract – more particularly, the inability of a contractor to perform a contract at the specified contract price . . . [is a] fundamental element[ ] of government contracts and [is] related to contract performance; as such, [it is] highly relevant to the question of default." *McDonnell Douglas X,* 182 F.3d at 1328.

The A-12 contract as initially awarded had a target contract price of $ 4,379,219,436 and a ceiling price of $ 4,777,330,294. In June 1990, the contractors proposed that the fixed-price contract be modified because the cost of completing the contract would exceed the ceiling price so substantially that it would be "unacceptable" to the contractors.

The contractors repeatedly insisted on restructuring the contract from a fixed-price contract to a cost-reimbursement type contract. Even during the

high-level negotiation meetings following the government's issuance of the cure notice, Mr. John McDonnell, the CEO of MDC, asserted that the contractors "can't get there if we don't change the contract," and that the contract "has got to get reformed to a cost type contract or we cannot do it." In their January 2, 1991, written response to the cure notice, the contractors again submitted their proposal to restructure the contract to a cost reimbursement contract. In exchange for that restructuring, the contractors would absorb a $1.5 billion fixed loss and would waive their claims for equitable adjustment. The sizeable concession the contractors were willing to make further illustrates the grave inadequacy of the contract price.

Of course, the difficulty in the contractors' financial situation, in and of itself, may not be sufficient to justify the default termination. *See McDonnell Douglas XI*, 50 Fed. Cl. at 320-21 (ruling that the contractors' financial condition "was not endangering performance of the A-12 contract"). However, in this case, "inadequate financing is not collateral [because] it pervades the entire contract." *Universal Fiberglass*, 210 Ct. Cl. at 216. Indeed, in the months leading to the termination, the contractors were spending $120-150 million of their own money every month. *McDonnell Douglas XIII*, 76 Fed. Cl. at 427. Captain Lawrence Elberfeld, the Navy's A-12 Program Manager, testified that the cost to complete the A-12 contract would be so "unthinkably" over the fixed-price ceiling that the contractors' internal "worst case

estimate could bankrupt both corporations." *Id.* at 429.

More importantly, Captain Elberfeld testified that the cost overruns jeopardized the contractors' performance because the contractor engaged in "cost cutting efforts like reducing staff, eliminating overtime, quick fixes that address and would remedy a cash flow situation." *Id.* at 428. For example, around the time when the contractors missed the original first flight date, they removed 110 people from the A-12 program. *Id.* Captain Elberfeld concluded that the contractors' cost cutting efforts to avoid bankruptcy led to "more corner-cutting and more incomplete effort and basically a longer process to get a product that may not be the product that we desire or need for the Navy." *Id.* at 429.

c. *Conclusion*

In summary, the government offered the contracting officer's testimony, the contractors' statements, and contemporary documents as direct evidence. The evidence, such as the contractors' performance history (e.g., the failure to meet several milestones, including the significant first flight), coupled with the contractors' dire financial difficulty, which negatively impacted their performance under the contract, shows that the contracting officer was reasonably justified in feeling insecure about the contractors' rate of progress. Therefore, the government has

satisfied its burden to justify the default termination.[4]

Once the government has met this burden of proving that timely performance is beyond the contractors' reach, the contractors have the burden of going forward to prove either that they were making progress such that timely completion of the contract was not endangered or that there was excusable delay. *See Appeal of Mich. Joint Sealing, Inc.*, ASBCA No. 41477, 93-3 BCA 26,011 (Apr. 26, 1993). On appeal, the contractors assert no affirmative defense. They proffer no record evidence to show, without contract restructuring, that they could have completed the contract on any date. Certain arguments, such as waiver, are presented to support their proposition that, at termination, the A-12 contract lacked an enforceable completion date. Even if these arguments could be interpreted as the contractors' defenses, we have already addressed them elsewhere in this opinion. In conclusion, because the government was justifiably insecure about the contract's timely completion and the contractors do not argue that their

[4] Our current analysis may appear different from the one we previously instructed the trial court to perform, specifically, to determine the contract completion date. *See McDonnell Douglas XII*, 323 F.3d at 1018. We believe that this is warranted as under the law of the case doctrine, "it is not improper for a court to depart from a prior holding if convinced that it is clearly erroneous and would work a manifest injustice." *Arizona v. California*, 460 U.S. 605, 619, 103 S. Ct. 1382, 75 L. Ed. 2d 318 (U.S. 1983).

failure to make progress could be excused, we sustain the default termination of the A-12 contract.

3. *Default termination without contracting officer's Lisbon analysis*

The contractors and the *amicus curiae* also assert that we cannot uphold the default termination because the contracting officer, Admiral Morris, did not conduct the *Lisbon* analysis before the termination. They base this argument on the trial court's finding that "Admiral Morris did not determine the entire effort required and the time left to complete that contract effort prior to termination." *McDonnell Douglas XIII,* 76 Fed. Cl. at 424 n.72; *see also id.* at 437 n.92 (concluding "the contracting officer did not conduct a *Lisbon* analysis prior to termination"). This argument is unpersuasive.

First of all, as we have stated earlier, because the modified A-12 contract does not contain a fixed completion date, a *Lisbon* analysis cannot be strictly applied. Second, we previously stated that "the government is not required to establish that the contracting officer conducted the analysis necessary to sustain a default under the alternative theory." *Empire Energy Mgmt. Sys. v. Roche,* 362 F.3d 1343, 1357 (Fed. Cir. 2004); *see also Christopher Vill., L.P. v. United States,* 360 F.3d 1319, 1337 (Fed. Cir. 2004) ("This court sustains a default termination if justified by circumstances at the time of termination, regardless of whether the Government originally removed

the contractor for another reason." (quoting *Kelso v. Kirk Bros. Mech. Contractors, Inc.*, 16 F.3d 1173, 1175 (Fed. Cir. 1994))).

The contractors and the *amicus curiae* attempt to distinguish the present case from *Empire Energy*. The *amicus curiae* emphasizes that there is a "critical distinction between failure to make progress as the asserted basis for default at the time of termination, and failure to make progress as an alternative basis for default, proven at trial, that supports an otherwise unsustainable termination for failure to timely deliver." We discern no such distinction. In fact, the *amicus*'s contention is illogical-it would have us, on the one hand, uphold a default termination for failure to make progress when the contracting officer never even contemplated, much less evaluated, such a basis; while at the same time, reject another default termination for failure to make progress even though the contracting officer explicitly asserted such a basis.

More importantly, we are less concerned about the label of the contracting officer's action so long as, in fulfilling his duty, the contracting officer exercised reasoned judgment and did not act arbitrarily. After reviewing the record, we believe that the contractors are not victims of arbitrary government action. Admiral Morris testified that concerns about the A-12 Program "increased [and] the risks increased" in the fall of 1990. *Id.* at 424 n.70. The trial court found that

> [a]s the end of 1990 approached, [Admiral Morris] was concerned that substantial development on the aircraft had yet to occur. He testified "[t]he contractors were indicating that they were experiencing an overrun that they could not absorb. Cost was obviously a factor and their failure to fabricate components, their failure to meet schedule were clearly impacting cost."

Id. at 423-24.

Admiral Morris also testified that in the weeks leading to termination, the contractors "indicated that they would not be able to meet the delivery schedule that was currently in the contract. And they would not be able to perform the contract without extraordinary relief or additional funding for the contract." *Id.* at 424 (alterations omitted). He explained: "I didn't know at that particular time when in fact they would be able, if ever, to achieve performance of the contract and I was hearing 'we will not' or 'we could not.'" *Id.* (alterations omitted).

On December 17, 1990, Admiral Morris issued a cure notice, warning the contractors that their performance was "unsatisfactory" and the defect conditions were "endangering performance" of the contract. He explained that "[t]he purpose of the cure notice was to advise the contractors they were failing to make progress." *McDonnell Douglas XIII,* 76 Fed. Cl. at 402. He testified that he "had been extremely concerned with the communications coming in from the contractors that unless extraordinary relief were

provided, unless the contract were restructured into a cost-type contract, that they could not or would not perform, and that belief existed certainly on December 17th."

Admiral Morris considered the problems of cost overruns to be a "real issue." *McDonnell Douglas XIII,* 76 Fed. Cl. at 404. Even though he made an effort to resolve the issue "within the context of the contract" without restructuring the contract, "the contractors were insisting upon Public Law 85-804 extraordinary relief."[5] Even in their January 2, 1991, written response to the cure notice, the contractors again requested restructuring the contract to a cost reimbursement contract. On Sunday, January 6, 1991, Acting Under Secretary of Defense Donald Yockey told Admiral Morris that Secretary Cheney would not provide 85-804 relief. As a result, Admiral Morris thought that

> he had three choices: to terminate the contract for convenience, to terminate the contract for default, or to do nothing. He rejected the latter as 'irresponsible,' thus focusing his attention on the other two choices. He eliminated the termination for convenience first, because he believed

[5] Pub. L. No. 85-804, 72 Stat. 972 (1958) (codified as 50 U.S.C. § 1431), authorizes the President of the United States to grant agencies the power to provide extraordinary relief in furtherance of national defense.

> Contractors to be in material breach of the contract.

McDonnell Douglas X, 182 F.3d at 1328.

Record evidence shows that at the time of termination, Admiral Morris was justifiably insecure about the contract's timely completion. In addition, "a court's review of a default justification does not turn on the contracting officer's subjective beliefs, but rather requires an objective inquiry." *McDonnell Douglas XII,* 323 F.3d at 1016. In this regard, the facts in the record are sufficient for the court, in a *de novo* review, to sustain the default termination. *See Joseph Morton Co. v. United States,* 757 F.2d 1273, 1277 (Fed. Cir. 1985) ("It is settled law that a party can justify a termination if there existed at the time an adequate cause, even if then unknown.").

4. *Conclusion*

This is indeed an unfortunate case for all the parties involved. We realize that the court is not in a position to question the wisdom of the parties in entering this contract and subsequently, in handling problems in this case. Nevertheless, as the trial court recognized, "the Government rarely terminates fixed-price research and development contracts for default." *McDonnell Douglas XIII,* 76 Fed. Cl. at 418. We also observe that the CEOs of both MDC and GD, in a letter dated June 27, 1990, stated that "it was a mistake for the U.S. Navy to stipulate this type of contract and it was a mistake for the contractors to

accept it. Both are at fault." Alas, the law of contracts does not allow us to deviate from established principles of law and equity. We therefore hold that the default termination of the A-12 contract is justified.[6] However, we emphasize that terminating a government contract for failure to make progress when the contract does not specify a completion date is the exception, not the norm. Therefore, we reiterate that the *Lisbon* test remains good law and our conclusion here is dictated by the unique facts of this case.

IV. CONCLUSION

For these reasons, the judgment of the Court of Federal Claims is affirmed.

COSTS

Each party shall bear its own costs.

AFFIRMED

[6] The government argues that the contractors' failed to provide adequate assurance. As we hold that the default termination for failure to make progress is justified, we do not need to reach this argument.

MCDONNELL DOUGLAS CORPORATION, Plaintiff-Appellant, and GENERAL DYNAMICS CORPORATION, Plaintiff-Appellant, v. UNITED STATES, Defendant-Cross Appellant.

02-5034, 02-5035, 02-5046

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

323 F.3d 1006; 2003 U.S. App. LEXIS 4812; 60 Fed. R. Evid. Serv. (Callaghan) 1423

March 17, 2003, Decided

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JUDGES: Before MICHEL, CLEVENGER and LINN, Circuit Judges.

OPINION BY: CLEVENGER

OPINION

This case arises from the government's default termination in 1991 of a contract between the United States Navy and defense contractors McDonnell Douglas Corporation and General Dynamics Corporation (the "Contractors") to develop a carrier-based stealth aircraft. The Contractors challenge the judgment of the Court of Federal Claims in favor of the government, *McDonnell Douglas Corp. v. United States,* 50 Fed. Cl. 311 (Fed. Cl. 2001) ("*McDonnell Douglas XI*"), and the government cross-appeals for

the return of unliquidated progress payments. Since the trial court misunderstood our mandate and misapplied the controlling standard, we vacate its judgment and remand. However, we see no error in the trial court's determination that the unilateral schedule imposed by the government was enforceable and not waived, that the Military and State Secrets privilege precluded litigation of the Contractors' "superior knowledge" claim, and that the government's claim for progress payments was not at issue in the case.

I

A

Now in its twelfth year of litigation, this case once again returns to this court. We have previously provided in detail the facts underlying this contract dispute. *See McDonnell Douglas Corp. v. United States*, 182 F.3d 1319 (Fed. Cir. 1999) ("*McDonnell Douglas X*"). Thus, we will only provide a summary of the relevant background here.

In 1988, the Navy awarded McDonnell Douglas Corporation ("MDC") and General Dynamics Corporation ("GD") a fixed-price contract with a ceiling price of $4,777,330,294 to research and develop a carrier-based "stealth" attack aircraft called the "A-12 Avenger." *Id.* at 1322. The full-scale engineering and development ("FSD") contract required the Contractors to design and build eight stealth aircraft according to a specified delivery schedule, with the first aircraft to

be delivered in June 1990 and the remaining seven aircraft to be delivered monthly through January 1991. *Id.* The contract also gave the Navy the option to purchase four production lots of aircraft, and the Navy exercised its option on the first production lot in May of 1990. *McDonnell Douglas XI,* 50 Fed. Cl. at 313.

From the outset, the Contractors encountered difficulties in performing the contract, especially in meeting the contract schedule and in keeping the aircraft weight within specifications. *McDonnell Douglas X,* 182 F.3d at 1322. In June of 1990, the Contractors informed the Navy that they could not deliver the first aircraft on time and that the cost of completing the contract would substantially exceed the ceiling price. *Id.* As a solution, the Contractors proposed to restructure the fixed-price agreement into a cost-reimbursement contract. *Id.* Despite their negotiations, the parties could not reach an agreement on the proposed contract restructuring or on a new delivery date. *Id.* So, in August of 1990, the Navy issued a unilateral schedule modification, continuing the first flight and delivery date to December 31, 1991. *Id.*

Subsequently, more problems arose concerning the FSD contract, leading the Department of Defense ("DoD") and the Navy to question the viability of the project. *Id.* at 1322-23. On December 17, 1990, Rear Admiral William Morris, the contracting officer, sent a cure notice to the Contractors, informing them of his intention to terminate the contract for default

based on the Contractors' failure to timely fabricate the required parts and to meet specification requirements. *See id.* at 1323. In their response dated January 2, 1991, the Contractors conceded that they could not meet the new delivery schedule, but denied that they were in default and asserted that the new delivery schedule was invalid or unenforceable. *Id.* As suggested cure, they again submitted a proposal to restructure the FSD agreement to a cost-reimbursement contract. *Id.* In exchange for that restructuring, the Contractors would absorb $1.5 billion in fixed loss and would waive their claims for equitable adjustment. *Id.*

After numerous meetings with DoD and Navy principals, Admiral Morris terminated the contract for default on January 7, 1991. *Id.* at 1323-24. A few weeks later, the Navy sent a letter to the Contractors demanding the return of approximately $1.35 billion in unliquidated progress payments under the terminated contract. *Id.* at 1324.

In June of 1991, the Contractors sought relief in the Court of Federal Claims under the Contract Disputes Act, 41 U.S.C. § 609(a) (2000). After protracted litigation, the trial court held that the Contractors' performance did not constitute the basis for the Navy's decision to terminate, and the court therefore converted the default termination into a termination for convenience. *McDonnell Douglas X*, 182 F.3d at 1324. On appeal, we reversed that judgment, holding that the termination was related to the Contractors' performance. *Id.* at 1326-29. We

remanded the case to the trial court to determine whether the default termination was justified. *Id.* at 1329.

After a six-week trial on remand, the Court of Federal Claims ruled in favor of the Navy. *McDonnell Douglas XI*, 50 Fed. Cl. at 319. The trial court sustained the default based solely on the Contractors' failure to meet the December 1991 first flight date. *Id.* at 315-19. It declined to base its determination of justified default on the Contractors' alleged financial inability to perform the contract, anticipatory repudiation, and failure to comply with weight and other specification requirements. *Id.* at 319-24. Turning to the Contractors' defenses, the trial court rejected their arguments that the unilateral schedule was unreasonable and therefore unenforceable, or, if enforceable then the Navy waived the unilateral schedule and first flight date of December 1991; that the contract was commercially impossible to perform; and that the Navy had to disclose its alleged superior knowledge despite the assertion of the state secrets privilege. *Id.* at 324-26. Having addressed those issues, the Court of Federal Claims entered judgment in favor of the government. *Id.* at 326.

After entry of judgment, the government asserted its right to immediately collect from the Contractors $1.35 billion in progress payments. Because the trial court determined that the government did not submit a counterclaim and that the unliquidated damages were not an issue in the litigation, the Court of Federal Claims ruled "it was not necessary for this

court to address what we consider to be an understanding among the parties that was outside the focus of this case."

The Contractors appealed the trial court's judgment and challenged the trial court's construction of our mandate, determination that the unilateral schedule was enforceable and unwaived, and dismissal of their "superior knowledge" claims. The government cross-appealed for the return of the $1.35 billion in unliquidated progress payments. We have jurisdiction over this case pursuant to 28 U.S.C. § 1295(a)(3).

B

We review issues of law *de novo,* without deference to the trial court. *Bass Enters. Prod. Co. v. United States,* 133 F.3d 893, 895 (Fed. Cir. 1998). This plenary review also applies to interpretations of our own mandate. *Engel Indus., Inc. v. Lockformer Co.,* 166 F.3d 1379, 1382 (Fed. Cir. 1999). However, we will not disturb the trial court's factual findings, such as its evaluation of evidence of default, unless they are clearly erroneous. *See Lisbon Contractors, Inc. v. United States,* 828 F.2d 759, 766 (Fed. Cir. 1987). A factual finding is clearly erroneous when the reviewing court is left with a "definite and firm conviction that a mistake has been committed." *United States v. United States Gypsum Co.,* 333 U.S. 364, 395, 92 L. Ed. 746, 68 S. Ct. 525 (1948).

II

A

On remand, the Court of Federal Claims sustained the default termination based solely on the Contractors' conceded inability to make the December 1991 first flight date. *McDonnell Douglas XI*, 50 Fed. Cl. at 315-19. As it explained, if it found that the first flight date was reasonable, "the Circuit's finding that the Government's decision to terminate for default was performance-related will require us to rule for defendant." *Id.* at 313. Thus, the trial court construed our mandate as having disposed of certain issues related to the merits of the default termination and as limiting its inquiry to "whether the Navy's unilateral modification establishing a new schedule for first flight was reasonable." *Id.*

The Court of Federal Claims, however, misconstrued our mandate. Although the trial court believed that we disposed of certain issues related to the Navy's justification for the default termination, a plenary review of our opinion in *McDonnell Douglas X* belies that proposition. *See Engel Indus.*, 166 F.3d at 1382 ("We review the interpretation of our own mandate de novo.").

In *McDonnell Douglas X*, we only addressed two major issues: (1) the government's challenge to the trial court's conversion of a default termination into one for convenience; and (2) the Contractors' cross-appeal that the government was without power to terminate an incrementally-funded contract for default.

McDonnell Douglas X, 182 F.3d at 1325-32. We did not reach the other appealed issues based on our reversal of the conversion question.

In addressing the propriety of converting the default termination, we first determined that the Court of Federal Claims misinterpreted the holding of *Schlesinger v. United States,* 182 Ct. Cl. 571, 390 F.2d 702 (Ct. Cl. 1968). *McDonnell Douglas X,* 182 F.3d at 1325-26. We explained that *Schlesinger* and its progeny only barred terminations for default where there is no nexus between the default termination and the Contractors' performance under the contract. *Id.* We then ruled, based on the trial court's findings of fact, that the termination of the FSD contract for default was related to the Contractors' performance of the contract and that a remand was necessary. *Id.* at 1326-29. We concluded our review of the conversion issue by stating:

> On remand, if the government can establish that Contractors were in default, then the termination for default would be valid. *See Lisbon Contractors, Inc. v. United States,* 828 F.2d 759, 765 (Fed. Cir. 1987) (holding that the government bears the burden of proof with respect to the issue of whether termination for default was justified). Conversely, if the government is not able to make this showing, then the default termination was invalid and Contractors would

> be entitled to a suitable recovery, presumably under a termination for convenience theory.

Id. at 1329.

After vacating the trial court's rulings on the loss-ratio and doctrine of superior knowledge in light of our disposition of the conversion question, *id.* at 1329-30, we addressed whether the government had the authority to terminate for default an incrementally-funded contract. *Id.* at 1330. On that issue, we determined that the government had that authority, holding "only that the contract, throughout its term, embodied a duty to make progress toward the ultimate end item." *Id.* at 1332. We finished that discussion by stating, once again:

> The question of whether Contractors satisfied their duty is of course that of breach, and must be determined by taking into account all of the relevant facts and testimony, such as Contractors' statements that they could not meet the contract specifications, the contract delivery schedule, nor complete performance at the specified contract price. *See supra* Part II.B. We leave it to the trial court to resolve these issues in the first instance.

Id. The conclusion section of our opinion reiterated those limited rulings and instructed the trial court to afford the parties an opportunity to litigate the legitimacy of the default termination's justification. *Id.* at 1332-33.

Our decision in *McDonnell Douglas X* did not state whether there was in fact a default. Our ruling had a limited scope, and we emphasized that point by refusing to address the merits of the government's default justification. *Id.* at 1332 ("Of course, we do not hold today that the government's default termination is justified."). Neither the text of our opinion nor its related judgment contained any indication, expressly or by intimation, that we intended to limit the default justification inquiry on remand to the reasonableness of the December 1991 delivery date. And, there is nothing in the trial court's opinion that elucidates the basis for its misinterpretation of our mandate. Therefore, we must conclude that the Court of Federal Claims misunderstood our mandate.

Because our decree does not require such a result, the trial court's finding that the unmet first flight date in December 1991 was reasonable is insufficient to sustain a default termination in this case. *See Lisbon,* 828 F.2d at 765 (stating that "the government did not, as it urges, satisfy its burden by merely showing that the contractor was behind schedule"). Consequently, the judgment in favor of the United States cannot stand on that sole ground.

Although the parties have requested that we finally dispose of this protracted litigation on appeal, the record at this point does not permit us to do so. In determining whether a default termination was justified, a court must review the evidence and circumstances surrounding the termination, and that assessment involves a consideration of factual and evidentiary

issues. *See id.* at 766-67 (reviewing trial court's factual findings and decision regarding default termination for clear error). Because the Court of Federal Claims focused its ruling on the reasonableness of the December 1991 date, it did not make adequate findings on whether the Navy justifiably terminated the Contractors for default. Mindful of our limited role as a court of appeals, *Baxter Healthcare Corp. v. Spectramed, Inc.*, 49 F.3d 1575, 1585 (Fed. Cir. 1995) (emphasizing that "we sit as a court to review claims that a trial judge erred, and not as a court of first instance"), we decline to resolve this dispute on an incomplete record. Accordingly, we have no choice but to vacate the trial court's judgment and remand for further proceedings.

B

On remand, the Court of Federal Claims must address the issue that warranted a remand in *McDonnell Douglas X*: "[W]hether the government's default termination was justified, an issue upon which we express or intimate no view." *McDonnell Douglas X*, 182 F.3d at 1321. However, the parties could not agree in this appeal on the proper legal standard applicable to that inquiry. Since the determination of legal standards is a pure issue of law, *see Bayer AG v. Schein Pharms., Inc.*, 301 F.3d 1306, 1312 (Fed. Cir. 2002) (indicating that the choice of legal standards is a legal question), we now resolve that dispute and clarify the requirements for

determining whether the government has proved that the Contractors were in default.

In this case, the government's authority to terminate the contract for default derives from the incorporated terms of FAR 52.249-9. That FAR clause provides:

> (a)(1) The Government may, subject to paragraphs (c) and (d) below, by written Notice of Default to the Contractor, terminate this contract in whole or in part if the Contractor fails to-
>
> . . .
>
> (ii) Prosecute the work so as to endanger performance of this contract (but see subparagraph (a)(2) below);

48 C.F.R. § 52.249-9 (1984). The plain language of the default provision permits termination whenever the contractor fails to "[p]rosecute the work so as to endanger performance of this contract." *Id.*

The parties advance drastically opposite interpretations of this default provision. The Contractors contend that our precedent, such as *Lisbon,* permits a default termination only upon repudiation or impossibility of performance. As they explain, "a contractor's deficiencies must therefore be so severe as to be the practical equivalent of a repudiation or abandonment of the entire contract effort." Because the Contractors believe that "it must be clear that the contractor cannot or will not complete performance," they

submit that it is improper to default terminate a contractor merely because it is unable to meet an interim contract milestone. The government, in contrast, argues that the interpretation of this specific default provision is an issue of first impression and that the circumstances of this case are so different that we should not seek guidance from precedent. Rather, according to the government, the default provision in this contract permits termination whenever a contractor raises concerns about its ability to satisfy a contractual requirement, such as meeting a schedule or some specification requirements. Under that construction of the default clause, the government argues that default termination was appropriate here given the Contractors' admitted inability to meet an interim contract milestone, the alleged impossibility for the aircraft design to meet contract specifications, and the Contractors' request for a restructuring of the agreement.

We disagree with the parties' interpretations of the default clause in this contract. Contrary to the Contractors' position, the default provision does not require absolute impossibility of performance or a contractor's complete repudiation or abandonment. *Discount Co. v. United States,* 213 Ct. Cl. 567, 554 F.2d 435, 441 (Ct. Cl. 1977) (holding that "the default clause in this contract did not require a finding that completion within the contract's time limitations was impossible"); *Universal Fiberglass Corp. v. United States,* 210 Ct. Cl. 206, 537 F.2d 393, 398 (Ct. Cl. 1976) (affirming default termination despite lack of

express repudiation). Nor does the provision permit, as the government implies, default termination based solely on a contractor's concerns about meeting a contractual schedule milestone or specification requirements. *See Lisbon,* 828 F.2d at 765. Rather, the proper interpretation of the default provision lies somewhere between the parties' extreme positions, and should strike a balance between the judicial aversion to default terminations, *see J.D. Hedin Constr. Co. v. United States,* 187 Ct. Cl. 45, 408 F.2d 424, 431 (Ct. Cl. 1969) (stating that "a default termination is a drastic sanction which should be imposed (or sustained) only for good grounds and on solid evidence" (citation omitted)), and the fact that "the Government, just as any other party, is entitled to receive that for which it contracted and has the right to accept only goods that conform to the specification." *Cascade Pac. Int'l v. United States,* 773 F.2d 287, 291 (Fed. Cir. 1985) (affirming finding of default termination).

The pragmatic approach we adopted in *Lisbon* achieves that desired balance and provides the proper interpretation of the default clause.[1] Like this case,

[1] Although the government distances itself from *Lisbon* in this appeal, it relied on that precedent throughout the proceedings on remand. Indeed, the government urged the Court of Federal Claims to apply the *Lisbon* standard in its opening argument, during trial, in its closing statement, and in its post-trial briefs. Our jurisprudence does not condone such a reversal in position between trial and appeal. *See Interactive Gift Express, Inc. v. Compuserve Inc.,* 256 F.3d 1323, 1345 (Fed. Cir.

(Continued on following page)

Lisbon involved a default termination of a contractor for failure to prosecute with diligence, despite the fact that the contractor still had time to complete performance of the contracted project. *Lisbon,* 828 F.2d at 765-66. After determining that the government bore the burden of proof in justifying a default termination, *id.* at 765, we clarified that "the government did not, as it urges, satisfy its burden by merely showing that the contractor was behind schedule." *Id.* Rather, we construed the default provision to "require reasonable belief on the part of the contracting officer that there was no reasonable likelihood that the contractor could perform the entire contract effort within the time remaining for contract performance." *Id.* (internal quotation marks and brackets omitted) (quoting *RFI Shield-Rooms,* ASBCA Nos. 17374, 17991, 77-2 BCA P 12,714, 61,735 (Aug. 11, 1977), and citing *Discount,* 554 F.2d at 441). Since then, we have adopted that formulation as the controlling standard in default cases involving a failure to make sufficient progress.[2] *See, e.g., Danzig v. AEC Corp.,* 224 F.3d

2001) ("The doctrine provides that a party will be judicially estopped from asserting a position on appeal that is directly opposed to a position that the party successfully urged at trial.").

[2] This standard is accepted and applied by the contract boards and trial courts in reviewing default terminations for failure to make progress. Indeed, the Boards of Contract Appeals, whose specialized expertise with government contracts is entitled to respect, have long adopted the *Lisbon* standard in reviewing the government's default termination of contractors who allegedly failed to prosecute their work with diligence. *See, e.g., Bison Trucking & Equip. Co.,* ASBCA No. 53,390, 2001-2

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1333, 1336-37 (Fed. Cir. 2000) (indicating that the ASCBA properly applied the *Lisbon* standard in reviewing a default termination for failure to make progress). We again reaffirm in this case that the test formulated in *Lisbon* controls the determination of whether the government justifiably default terminated a contractor for failure to make progress.

In applying that standard, we have required that the contracting officer's termination decision be based on tangible, direct evidence reflecting the impairment

B.C.A. (CCH) P 31,654 (ASCBA Nov. 21, 2001); *Thomas & Sons, Inc.*, ASBCA No. 51,874, 01-1 B.C.A. (CCH) P 31,166 (ASBCA Nov. 13, 2000); *Santee Dock Builders*, AGBCA No. 96-161-1, 99-1 B.C.A. (CCH) P 30,190 (AGBCA Dec. 17, 1998); *Nat'l Interior Contractors, Inc.*, ASBCA No. 46,089, 96-2 B.C.A. (CCH) P 28,370 (ASBCA May 23, 1996); *Am. Int'l Contractors, Inc./Capitol Indus. Constr. Groups, Inc.*, ASBCA No. 39,544, 95-2 B.C.A. (CCH) P 27,920 (ASBCA Aug 31, 1995); *Hillebrand Constr. of Midwest, Inc.*, ASBCA No. 45,853, 95-1 B.C.A. (CCH) P 27,464, (ASBCA Jan. 18, 1995); *Mich. Joint Sealing, Inc.*, ASBCA No. 41,477, 93-3 B.C.A. (CCH) P 26,011 (ASBCA Apr. 26, 1993), *aff'd*, 22 F.3d 1104 (Fed. Cir. 1994) (table); *Skip Kirchdorfer, Inc.*, ASBCA Nos. 32,637, 35,074, 91-1 B.C.A. (CCH) P 23,380 (A.S.B.C.A. Sept. 13, 1990), *aff'd*, 944 F.2d 912 (Fed. Cir. 1991) (table); *B.M.S., Inc.*, ASBCA No. 35,430, 90-2 B.C.A. (CCH) P 22,644 (ASBCA Jan. 26, 1990). Similarly, the Court of Federal Claims has applied the *Lisbon* standard in reviewing default terminations for failure to make progress. *See, e.g., Morganti Nat'l, Inc. v. United States*, 49 Fed. Cl. 110, 129-32 (Fed. Cl. 2001) (affirming default termination), *aff'd*, 36 Fed. Appx. 452 (Fed. Cir. 2002); *CJP Contractors, Inc. v. United States*, 45 Fed. Cl. 343, 371 (Fed. Cl. 1999) (reversing default); *Interstate Gen. Gov't Contractors, Inc. v. United States*, 40 Fed. Cl. 585, 606-08 (Fed. Cl. 1998) (reversing default).

of timely completion. *See Lisbon,* 828 F.2d at 766 ("At trial, the government did not offer *direct* testimony or any other *direct* evidence on the time which it estimated it would take Lisbon to complete the contract."). In other words, a court's review of default justification does not turn on the contracting officer's subjective beliefs, but rather requires an objective inquiry. *Id.* at 766-67 (reviewing evidence underlying government's default termination). Although the contracting officer's testimony and contemporaneous documents are relevant to that determination, *id.* at 766, the trial court may also consider other factors usually relied upon by courts and contract boards, such as a comparison of the percentage of work completed and the amount of time remaining under the contract, *see, e.g., Thomas & Sons, Inc.,* ASBCA No. 51,874, 01-1 B.C.A. (CCH) P 31,166 (ASBCA Nov. 13, 2000); *Nat'l Interior Contractors, Inc.,* ASBCA No. 46,089, 96-2 B.C.A. (CCH) P 28,370 (ASCBA May 23, 1996); the contractor's failure to meet progress milestones, *see, e.g., James E. Kennedy, Tr. v. United States,* 164 Ct. Cl. 507, 512 (1964); *AAR Corp.,* ASBCA No. 16,486 et al., 74-2 B.C.A. (CCH) P 10,653 (A.S.B.C.A. Apr. 24, 1974); problems with subcontractors and suppliers, *see, e.g., Abcon Assocs., Inc. v. United States,* 49 Fed. Cl. 678, 686-87 (Fed. Cl. 2001); the contractor's financial situation, *see, e.g., Universal Fiberglass,* 537 F.2d at 395-96, 398; as well as a contractor's performance history, *see, e.g., Decker & Co. v. West,* 76 F.3d 1573, 1581 (Fed. Cir. 1996); and other pertinent circumstances surrounding the decision in order to determine whether the contracting

officer had a valid basis for his conclusions. *Lisbon,* 828 F.2d at 766-67; *see also Discount,* 554 F.2d at 441 ("The record is plain, however, that the default termination was not based on this demand *per se* but rather on the over-all evidence of Discount's failure to prosecute diligently its work under the contract."); *L & H Constr. Co.,* ASBCA No. 43,833, 97-1 B.C.A. (CCH) P 28,766 (ASBCA Feb. 5, 1997) ("The Government owes the contractor no less than an assessment of all the relevant circumstances when it exercises its discretion under the default clause.").

Our precedent does not require, however, that the contracting officer be correct in his assessment, as the Contractors would have us rule. He only needs to be "justifiably insecure about the contract's timely completion." *Discount,* 554 F.2d at 441. Because the inquiry is concerned with the contracting officer's reasonable belief rather than whether he was correct, it would be impermissible "to show that after the termination action events occurred which would have permitted the contract to be completed by the delivery date." *RFI Shield-Room,* 77-2 B.C.A. (CCH) P 12,714 (cited with approval by *Lisbon,* 828 F.2d at 765). A consideration of post-termination factors and events would transform *Lisbon's* "reasonable belief" requirement into a demand that the contracting officer have perfect foresight. Limiting the inquiry to the time of the termination action reduces the potential for hindsight bias. *See RFI Shield-Room,* 77-2 B.C.A. (CCH) P 12,714. Thus, the trial court should focus on the events, actions, and communications

leading to the default decision in ascertaining whether the contracting officer had a reasonable belief that there was no reasonable likelihood of timely completion.

To make that determination, the Court of Federal Claims will first have to decide the actual performance that the contract requires and the amount of time remaining for performance. *See Lisbon,* 828 F.2d at 766 (faulting the government for failing to provide "*direct* evidence on the time which it estimated it would take [the contractor] to complete the contract."). Unless the contracting officer had determined the entire effort required under the contract and the time left to complete the contract, it would be difficult, if not impossible, for him to resolve whether "there was no reasonable likelihood that the contractor could perform the *entire contract effort within the time remaining for contract performance.*" *Id.* at 765 (emphasis added and brackets omitted).

In this case, the parties do not agree on either of those underlying issues. They each harbor differing views of the contract completion date, ranging from the opinion that no such date existed, to the notion that the design and testing under the contract would require at least four to five years, to the suggestion that missing the first aircraft delivery date was tantamount to failing to timely complete the contract. In addition, the parties seem unsure whether the contract solely requires delivery of the eight prototype aircraft or whether the agreement also requires delivery of the production lot purchased by the Navy

under the contract's option provisions. Given those competing claims and the incomplete record before us, we leave it to the trial court to determine on first instance the actual performance required by the contract and the amount of time remaining for that performance.

To summarize, on remand, once the Court of Federal Claims determines the performance required by the contract and the contract completion date, it can then decide, in light of the information upon which the contracting officer relied in deciding to terminate for default, whether the government has met its burden of proving that the contracting officer had a reasonable belief that there was no reasonable likelihood that the contractor could perform the entire contract effort within the time remaining for performance.[3] As we explained in *McDonnell Douglas X:*

> On remand, if the government can establish that Contractors were in default, then the termination for default would be valid. Conversely, if the government is not able to make this showing, then the default

[3] Although the parties disagreed at oral argument whether the trial court should show any deference to the contracting officer's decision, it is well-settled that the Court of Federal Claims reviews the decision to terminate a contractor for default *de novo*. *See Wilner v. United States*, 24 F.3d 1397, 1401 (Fed. Cir. 1994) (en banc) ("[I]n court litigation, a contractor is not entitled to the benefit of any presumption arising from the contracting officer's decision. De novo review precludes reliance upon the presumed correctness of the decision.").

> termination was invalid and Contractors would be entitled to a suitable recovery, presumably under a termination for convenience theory.

McDonnell Douglas X, 182 F.3d at 1329 (citation omitted). Whether the government has met its burden is not an issue we reach here, since it is a determination that we yield initially to the trial court and on which we neither express nor intimate any view. *See Olson Plumbing & Heating Co. v. United States,* 221 Ct. Cl. 197, 602 F.2d 950, 955 (Ct. Cl. 1979) (stating that "whether the default termination is proper depends upon the facts and circumstances of each case"). Similarly, we decline to decide whether the Court of Federal Claims needs to conduct additional proceedings or admit additional evidence, as those matters are better left to the trial court's broad discretion. We merely hold and reaffirm in this case that the test we adopted in *Lisbon,* as further explained in this opinion, controls the review of default termination for failure to make progress.

III

We now turn to the other issues raised by Contractors in this appeal. The Contractors challenge the trial court's determination that the government's unilateral schedule was enforceable and not waived. Moreover, they contend that it was reversible error to preclude them from litigating their "superior knowledge" claim based on the government's invo-

cation of the Military and State Secrets privilege. We address each contention *seriatim*.

A

After the Contractors failed to meet the June 1990 delivery date and the parties could not agree on a new bilateral schedule, the Navy unilaterally imposed a new delivery schedule through the issuance of Modification No. P00046. Because the unilateral schedule was allegedly not reasonable, the Contractors argue that the schedule is not enforceable. We disagree.

If the government elects to permit a delinquent contractor to continue performance past a due date as it did in this case by waiving the June 1990 delivery date, *McDonnell Douglas XI*, 50 Fed. Cl. at 315, the government can establish a new contract completion date, which will serve as a basis for default termination, either through a bilateral agreement with the contractor or by unilateral action. *DeVito v. United States*, 413 F.2d 1147, 1154-55, 188 Ct. Cl. 979 (Ct. Cl. 1969). If the government opts to act unilaterally, the new date that it sets must be "both reasonable and specific from the standpoint of the performance capabilities of the contractor at the time the notice is given." *Id.* at 1154. The reasonableness of the action turns on what the government "knew or should have known" at the time it imposed the new schedule. *ITT Corp. v. United States*, 509 F.2d 541, 549-50, 206 Ct. Cl. 37 (Ct. Cl. 1975).

Beyond this standard of reasonableness, our precedent does not impose the additional burdens that the Contractors would impose on the government when the United States unilaterally imposes a new completion date. Contrary to what GD contends, our precedent neither requires a determination of "what work remained to be completed as of the date the unilateral schedule was issued," nor does it necessitate an inquiry into "how long it likely would have taken the contractor to complete the remaining work, given its actual production capabilities as of the date the schedule was issued." Although those inquiries may be appropriate in certain situations, they are not requisite underpinnings for the *DeVito* reasonableness determination. Similarly, we reject the "objective achievability" paradigm suggested by the Contractors as not rooted in our precedent. Were we to adopt this new criterion, we would depart from our case law by requiring more than reasonableness; we would compel the government to have perfect prescience and be infallible in its decision. Because such an expectation is unachievable, the touchstone of this inquiry must remain grounded on reasonableness based on what the government knew or should have known when it adopted the unilateral schedule.

Based on the information available at that time, the government's unilateral schedule was reasonable. After the parties failed to agree on a new schedule, the government proceeded to adopt a new performance schedule through a methodical inquiry. Captain

Elberfeld, who prepared the schedule, conducted an independent analysis, taking into account all the issues and information then available to him. He did not solely rely on the Contractors' estimates, having lost confidence in their ability to correctly predict the schedule. Rather, he added an additional 25 percent for slippage on top of the Contractors' estimates, took into account the microcracking problems with the prototypes and the Contractors' work on resolving that issue, consulted with different qualified personnel of the Navy and the Contractors, and considered the Contractors' track-record and evidence of progress. As the trial court found, "once given his orders to develop a unilateral first flight schedule, Captain Elberfeld went about his mission in a thorough and comprehensive manner." *McDonnell XI,* 50 Fed. Cl. at 318. In fact, "Captain Elberfeld set a schedule that took into account the critical information that he had at the time." *Id.* at 318-19. On that basis, the Court of Federal Claims found that the December 1991 first flight date was reasonable and enforceable. We do not see any clear error in that finding.

B

Similarly, we agree with the Court of Federal Claims that the Navy did not waive the December 1991 first flight date. For a waiver of default to occur, there must be both a "(1) failure to terminate within a reasonable time after the default under circumstances indicating forbearance, and (2) reliance by the contractor on the failure to terminate and continued

performance by him under the contract, with the Government's knowledge and implied or express consent." *DeVito,* 413 F.2d at 1154. The application of this standard supports the conclusion of the trial court.

First, the facts do not substantiate the Contractors' allegations of forbearance based on the Navy's references to a date in the first quarter of 1992 as the first test flight date. The Navy mentioned that 1992 date on only two occasions, neither of which involves the necessary indicia of forbearance. The first time, when Captain Elberfeld mentioned the 1992 date during a presentation at the Tailhook Convention in September 1990, he was merely attempting to manage expectations and trying to provide an estimated date for planning purposes. The second time, when Captain Elberfeld told the Contractors at a Defense Acquisition Board meeting to assume a March 1992 first flight date, he made his statement contingent upon a restructured program that was being negotiated at that time but never materialized. The Court of Federal Claims, having heard the live testimony and having had the opportunity to assess the witnesses' credibility, found that those two situations did not amount to an intended forbearance. The record supports that finding, and the Contractors have not shown that trial court clearly erred.

Second, the Contractors failed to show any evidence of detrimental reliance on the government's alleged waiver. Although the Contractors spent over

$100 million every month to perform the contract, they would have done so regardless of whether their perceived deadline was December 1991 or March 1992. The significant monthly expenditure is not evidence of a change in position based on detrimental reliance; it just indicates that the Contractors were attempting to perform their contractual duties. The Contractors have not provided evidence, to this court or the trial court, that they adjusted their work or delayed their scheduled performance based on the expectation that the delivery date was four months later than December 1991. Without such evidence, we decline to disturb the Court of Federal Claims' finding that the government did not waive the December 1991 deadline.

C

Finally, we see no error in the trial court's decision to reject the Contractors' claim of "superior knowledge." As we previously explained, "[i]n government contracts law, under certain circumstances the government owes a duty to disclose critical information to a contractor that is necessary to prevent the contractor from unknowingly pursuing a ruinous course of action." *McDonnell Douglas X,* 182 F.3d at 1329 (internal quotation marks omitted). Failure to disclose such critical information may result in a finding that the government breached its contractual duty. *Id.* However, the Court of Federal Claims determined in this case that the Contractors could not proceed with that defense, because the litigation

of that claim would require extensive discovery into classified military information. *McDonnell Douglas XI,* 50 Fed. Cl. at 324-25. Specifically, the continued litigation may involve the disclosure of classified information regarding the B-2 and F117 stealth aircraft. Because the government has satisfied the requirements for the Military and State Secrets privilege, we affirm the decision of the Court of Federal Claims on this point.

The Military and State Secrets privilege allows the United States to block discovery in a lawsuit of any information that, if disclosed, would adversely affect national security. *Crater Corp. v. Lucent Techs., Inc.,* 255 F.3d 1361, 1370 (Fed. Cir. 2001). As the Supreme Court explained,

> [t]he privilege belongs to the Government and must be asserted by it; it can neither be claimed nor waived by a private party. It is not to be lightly invoked. There must be a formal claim of privilege, lodged by the head of the department which has control over the matter, after actual personal consideration by that officer. The court itself must determine whether the circumstances are appropriate for the claim of privilege, and yet do so without forcing a disclosure of the very thing the privilege is designed to protect.

United States v. Reynolds, 345 U.S. 1, 7-8, 97 L. Ed. 727, 73 S. Ct. 528 (1953) (footnotes omitted). Courts should accord the "utmost deference" to executive

assertions of privilege upon grounds of military or diplomatic secrets, and judicial review of such a claim of privilege is necessarily narrow. *See United States v. Nixon,* 418 U.S. 683, 710, 41 L. Ed. 2d 1039, 94 S. Ct. 3090 (1974). The court need only be satisfied that, under the particular circumstances of the case, "there is a reasonable danger that compulsion of the evidence will expose military matters which, in the interest of national security, should not be divulged." *Reynolds,* 345 U.S. at 10; *see also In re United States,* 277 U.S. App. D.C. 37, 872 F.2d 472, 475-76 (D.C. Cir. 1989).

Once the privilege is properly invoked by a government official with adequate authority and there is independent judicial review of the circumstances, "even the most compelling necessity cannot overcome the claim of privilege if the court is ultimately satisfied that military secrets are at stake." *Reynolds,* 345 U.S. at 11. The privilege is absolute, and "[n]o competing public or private interest can be advanced to compel disclosure of information found to be protected by a claim of privilege." *Ellsberg v. Mitchell,* 228 U.S. App. D.C. 225, 709 F.2d 51, 57 (D.C. Cir. 1983).

Thus, when the "very subject matter of the action" is a state or military secret, the action must give way to the proper invocation of the state secrets privilege. *See Totten v. United States,* 92 U.S. 105, 107, 23 L. Ed. 605, 11 Ct. Cl. 182 (1875) ("[P]ublic policy forbids the maintenance of any suit in a court of justice, the trial of which would inevitably lead to

the disclosure of matters which the law itself regards as confidential, and respecting which it will not allow the confidence to be violated."). Although harsh, the presence of a properly invoked state secrets privilege requires dismissal of the claim that cannot prevail without the privileged information. *Reynolds*, 345 U.S. at 11 n.26; *Zuckerbraun v. Gen. Dynamics Corp.*, 935 F.2d 544, 547-48 (2d Cir. 1991) (affirming dismissal of action upon intervenor United States' proper invocation of state secrets); *Weston v. Lockheed Missiles & Space Co.*, 881 F.2d 814, 816 (9th Cir. 1989) (recognizing that state secrets privilege alone can be the basis of the dismissal of a suit); *Bentzlin v. Hughes Aircraft Co.*, 833 F. Supp. 1486, 1495-97 (C.D. Cal. 1993) (dismissing case based on, *inter alia*, state secrets privilege); *see also DTM Research, LLC v. AT&T Corp.*, 245 F.3d 327 (4th Cir. 2001) (ruling that the quashing of subpoena on the United States that threatened state secrets did not foreclose possibility of fair trial and thus did not warrant dismissal). Because of its breadth and severe effect, the privilege should not be lightly invoked and found. *Reynolds*, 345 U.S. at 8.

In this case, the two requirements for applying the state secrets doctrine were satisfied. First, the Secretary of the Air Force made the formal assertion by submitting a declaration setting forth the reasons for invoking the privilege.[4] As he explained, discovery

[4] Although this case involves the Navy, the person authorized by the President in Executive Order 12,958 to

(Continued on following page)

of the information sought by the Contractors may lead to inadvertent and unauthorized disclosure of the stealth technology unavailable in other countries and may pose a grave risk to our national security. To buttress that assertion, he also submitted to the trial court, for *in camera* review, a classified declaration that provided in more detail the specific reasons why disclosure of the information sought by the Contractors would endanger our national and military interests.

Second, after review of the declarations and the circumstances surrounding the invocation of the privilege, the trial court determined that the circumstances for the assertion were appropriate. In the original trial, a series of security breaches and discovery abuses led the trial court to conclude that litigation of the superior knowledge could not proceed. *McDonnell Douglas X*, 182 F.3d at 1329. On appeal, we vacated the state secrets determination in light of the reversal of the default termination conversion. *Id.* at 1329-30. We invoked the trial court's discretion to reconsider that issue. On remand, the Contractors' renewed discovery requests again prompted the Air Force to invoke its Military and State Secrets privilege. After considering the renewed assertion of privilege and the situation surrounding it, the Court of Federal Claims found that "[n]either the passage of time nor intervening developments

determine the proper classification of information is the Secretary of the Air Force.

have lessened the risks that prompted us to act in the first instance."

We agree with that ruling. Not only has the Secretary of the Air Force properly invoked the privilege as required by the Supreme Court, but to litigate the superior knowledge claim would require giving the Contractor's attorneys access to the classified information and ultimately divulging the information at trial. *See Fitzgerald v. Penthouse Int'l, Ltd.*, 776 F.2d 1236, 1242-44, 1242 n.8 (4th Cir. 1985) (providing that privilege requires dismissal of claim thereby preventing disclosure at trial of classified information despite the fact that one of the parties had "personal knowledge of classified matters within the scope of the state secrets privilege"). Given the history of security breaches and discovery abuses in this litigation, *McDonnell Douglas Corp. v. United States*, 37 Fed. Cl. 270, 276-78 (Fed. Cl. 1996) (discussing pattern of security lapses during discovery, including inappropriate deposition questions by the Contractors' counsel that led to the disclosure of classified information and the use of classified information in open court and other unclassified documents), there is a risk that the military and state secret once divulged is unlikely to remain protected in this case. The public good must prevail over individual needs by enforcing the privilege and protecting the military secrets at issue here. *See Reynolds*, 345 U.S. at 11 n.26. We see no reason to fault the trial court's conclusion that the government's privilege was properly invoked and that the

privilege bars further adjudication of the superior knowledge claim.

The Contractors concede that the properly invoked privilege attaches to this proceeding. Instead, they contend that the *Due Process Clause of the Fifth Amendment* trumps the privilege by giving them a right to present all available defenses, including the superior knowledge defense. Relying on an application of the *Due Process Clause* in criminal cases, the Contractors argue that the *Fifth Amendment* compels the government to choose between fully disclosing classified information and proceeding with the prosecution of its claim. According to the plaintiffs, because the government refused to fully disclose the secrets, the default termination decision must be dismissed. However, in making that argument, the Contractors essentially conflate rules governing criminal and civil proceedings, elevating this civil contract dispute into the constitutional territory of a criminal prosecution. The Supreme Court has already considered the Contractors' very argument in the Military and State Secrets privilege context and rejected it:

> Respondents have cited us to those cases in the criminal field, where it has been held that the Government can invoke its evidentiary privileges only at the price of letting the defendant go free. The rationale of the criminal cases is that, since the Government which prosecutes an accused also has the duty to see that justice is done, it is

> unconscionable to allow it to undertake prosecution and then invoke its governmental privileges to deprive the accused of anything which might be material to his defense. Such rationale has no application in a civil forum where the Government is not the moving party, but is a defendant only on terms to which it has consented.

Reynolds, 345 U.S. at 12 (footnote omitted). The Contractors are not at jeopardy from an attack on them by the government. Rather, they are the plaintiffs in this purely civil matter, suing the sovereign on the limited terms to which it has consented. Thus, the Fifth Amendment does not require that they be able to present all defenses, including a defense that would threaten national security. Complying with the high court's edict as we must, we therefore reject the Contractors' Fifth Amendment contention.

Without a legal basis for their argument, the Contractors support their contention with practical concerns. According to the Contractors, an affirmance of the trial court's ruling on this issue would permit the government to abuse its authority as both litigant and sovereign and would lead it to use default termination as a ready alternative to terminations for convenience. For those reasons, the Contractors submit that they must have a right to either gain access to the military secrets or have the default termination vacated. We disagree. First, although the Contractors ascribe a fraudulent and deceptive intent to the government and its agents, they have not

presented any evidence or corroborative facts to support their allegations. Nor have they cited any case in which the government has actually misused the Military and State Secrets privilege as they describe. Second, if we acceded to the Contractors' request and burdened the government with a duty in a civil setting to either divulge the state secrets or face an adverse disposition of the suit, we would ignore controlling precedent from the Supreme Court and authorities from other circuits that have unequivocally dismissed private claims that threatened to expose a state secret protected by the privilege. *Reynolds,* 345 U.S. at 11-12; *Zuckerbraun,* 935 F.2d at 547-48; *Weston,* 881 F.2d at 816; *Molerio v. Fed. Bureau of Investigation,* 242 U.S. App. D.C. 137, 749 F.2d 815, 825 (D.C. Cir. 1984) (granting summary judgment for government after determining that the privilege was properly invoked and applied in that case); *Farnsworth Cannon, Inc. v. Grimes,* 635 F.2d 268, 281 (4th Cir. 1980) (en banc) (affirming dismissal of a contractor's suit against a Navy employee for wrongful interference with prospective contractual relations, because the court was concerned about interrogating witnesses in open court about sensitive matters); *Bentzlin,* 833 F. Supp. at 1495-97. This well-established precedent demonstrates that, when a properly invoked claim of State Secrets privilege undercuts a civil litigant's opportunity to prove its case, the interests favoring the protection of the state secret always prevail. We see no reason to deviate from this settled law.

Because the requirements for the Military and State Secrets privilege to attach were satisfied, we affirm the trial court's refusal to permit further litigation of the Contractors' superior knowledge claims.

IV

The government also filed a cross-appeal, claiming entitlement to the recoupment of unliquidated progress payments made to the Contractors. The trial court declined to enter judgment for the government because it did not find it necessary to address that claim.

We similarly decline to rule on this premature cross-appeal. As the government admits, "until entry of a judgment sustaining the default, our so-called 'claim' for the unliquidated progress payments would not have been ripe." Since we vacated the trial court's judgment sustaining the default termination, the claim for a monetary judgment in the government's favor has lost its necessary predicate and is therefore not ripe for appellate review.

V

In sum, because the Court of Federal Claims did not apply the controlling standard under *Lisbon* to this case, we vacate its ruling that the default termination was justified and remand for further proceedings consistent with this opinion. As to the

Contractors' appeal of other discrete issues, we affirm the trial court's decisions on the enforceability and nonwaiver of the unilateral schedule and on the dismissal of the Contractors' "superior knowledge" claim in light of the government's proper assertion of the Military and State Secrets privilege. Finally, we decline to address or disturb the trial court's decision related to the government's claim for unliquidated progress payments.

COSTS

Each party shall bear their costs.

VACATED-IN-PART, AFFIRMED-IN-PART, AND REMANDED.

MCDONNELL DOUGLAS CORPORATION, Plaintiff-Cross Appellant, and GENERAL DYNAMICS CORPORATION, Plaintiff-Cross Appellant, v. UNITED STATES, Defendant-Appellant.

98-5096, 98-5122, 98-5123

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

182 F.3d 1319; 1999 U.S. App. LEXIS 14805

July 1, 1999, Decided

COUNSEL: Bruce J. Ennis, Jr., Jenner & Block, Washington, DC, argued for plaintiffs-cross-appellants. With him on the brief were David W. DeBruin and Deanne E. Maynard. Also on the brief were Caryl A. Potter, III and Elizabeth A. Ferrell, Sonnenschein Nath & Rosenthal, Washington, DC. Of counsel on the brief were John W. Walbran, McDonnell Douglas Corporation, Berkeley, Missouri; Herbert L. Fenster and David A. Churchill, McKenna & Cuneo, L.L.P., Washington, DC; and Edward C. Bruntrager, General Dynamics Corporation, Falls Church, Virginia.

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Special Counsel for Litigation, Office of General Counsel, Department of the Navy, Arlington, Virginia.

JUDGES: Before MAYER, Chief Judge, MICHEL and CLEVENGER, Circuit Judges.

OPINION BY: CLEVENGER

OPINION

CLEVENGER, *Circuit Judge.*

This dispute arises out of the government's default termination of a contract between the United States Navy and defense contractors McDonnell Douglas Corporation and General Dynamics Corporation ("Contractors") to develop a carrier-based, low-observable "stealth" aircraft known as the A-12 Avenger. After several years of litigation, the United States Court of Federal Claims held that the government's termination of the contract for default could not be sustained because the government did not exercise the requisite discretion before entering a default termination, *see McDonnell Douglas Corp. v. United States,* 35 Fed. Cl. 358, 368-71 (1996) (hereinafter *McDonnell Douglas IV*), and converted the termination for default into a termination for convenience, awarding Contractors costs totaling $3,877,767,376. *See McDonnell Douglas Corp. v. United States,* 40 Fed. Cl. 529, 555-56 (1998) (hereinafter *McDonnell Douglas IX*). We hold that, because the termination for default was predicated on contract-related issues, it was within the discretion

of the government. Accordingly, the Court of Federal Claims' conversion of the termination for default into a termination for convenience was in error. We reverse the trial court's judgment and remand the case to the trial court for a determination of whether the government's default termination was justified, an issue upon which we express or intimate no view.

I

A

In 1984, the Department of the Navy introduced the Advanced Tactical Aircraft Program, known as the A-12 program, to develop a carrier-based stealth aircraft for the Navy. In January 1988, Contractors entered into a Full Scale Engineering Development contract (the "A-12 FSD Contract") with the government to produce eight FSD aircraft at a target price of $4,379,219,436. *See McDonnell Douglas IV,* 35 Fed. Cl. at 361. The contract was structured as an incrementally funded, fixed-price incentive contract with a ceiling price of $4,777,330,294, and recited a schedule of installment payments over the five-year term of the contract. The first aircraft was originally scheduled to be delivered in June 1990, and subsequent aircraft were to be delivered each month through January 1991. *See id.* at 361-62.

From the outset, Contractors encountered difficulties in performing the contract. Particular problems included meeting the contract schedule and keeping the aircraft weight within specifications. At

the beginning of 1990, the Department of Defense initiated a Major Aircraft Review to evaluate various major aircraft programs in view of recent changes around the world and the corresponding reduced threat to national security. *See id.* at 362. The A-12 program was included in this Review, and Defense Secretary Richard Cheney visited the McDonnell Douglas plant as part of the review process. By the early part of 1990, the Navy's contracting officer knew that Contractors would not meet the delivery date for the first aircraft. *See id.* However, although Secretary Cheney was apprised of some concerns in the A-12 program, the review concluded that there was a continuing need for the A-12 and that the Navy should pursue the program. *See id.* at 363. Secretary Cheney reported these results during his testimony before Congress in April 1990.

In June 1990, Contractors informed the Navy that they could not meet the contract schedule, that the cost of completing the contract would substantially exceed the ceiling price, and that Contractors could not absorb the loss that would result from the contract. Contractors asserted that a fundamental problem with the FSD contract was its structure as a fixed-price contract and proposed that the contract be modified. Thereafter, Contractors submitted a proposal to change the contract schedule, but the Navy and Contractors failed to reach an agreement on that issue. Instead, on August 17, 1990, the Navy unilaterally issued a contract modification that changed the delivery schedule for the aircraft.

Under this modification, the delivery date of the first aircraft was delayed until December 1991, and the remaining aircraft became due periodically between February 1992 and February 1993. *See* Contract Modification P00046 P 1(b), Joint Appendix at 15,657.

In November 1990, Contractors submitted a formal request to the Navy to restructure the contract as a cost-reimbursement type contract. At the end of the same month, two reports were published which documented the handling of the A-12 program under the Major Aircraft Review. The Navy's "Beach Report," dated November 28, 1990, found that the A-12 program manager had been unreasonable both in reaching a conclusion that the contract could be performed within the ceiling price and in evaluating the risk of failing to meet the contract schedule. *See McDonnell Douglas IV,* 35 Fed. Cl. at 363. The Beach Report criticized several Navy officials involved in the A-12 program. Separately, a November 29, 1990 Department of Defense Inspector General report concluded that problems in the A-12 program were inaccurately identified during the Review because the Review did not accord with specified procedures and was otherwise handled poorly. *See id.*

During the Secretary's briefing to the President of the United States in early December 1990, the Secretary indicated his disappointment with the Navy's handling of the A-12 program and promised to take appropriate actions. On December 3, the Secretary directed the Deputy Secretary of Defense to review and report on the status of the A-12 program

within ten days. This resulted in several meetings by the Defense Acquisition Board and Defense Procurement Review Boards. In addition, on December 12, the Secretary of the Navy responded to Secretary Cheney's December 3 request with a memorandum that expressed concern about Contractors' ability and willingness to perform under the contract, and which noted in particular Contractors' belief that the government should assume responsibility for failure to meet goals under the contract, and that the government should restructure the contract. The memorandum concluded with a statement that the Navy would examine whether the contract should be terminated for default, and would make a recommendation to the Secretary by January 5, 1991. *See id.*

On Friday, December 14, Secretary Cheney directed the Secretary of Navy to show cause by January 4, 1991 why the A-12 program should not be terminated. The following Monday, December 17, the Navy issued a cure notice to Contractors stating that unless they were able to meet contract specifications by January 2, 1991, the government might choose to terminate the contract for default. In particular, the cure letter stated that, *inter alia,* Contractors had "failed to fabricate parts sufficient to permit final assembly in time to meet the schedule for delivery," and had "fail[ed] to meet specification requirements." Joint Appendix at 16,524. The letter asserted that "[t]hese conditions are endangering performance of [the] contract." *Id.*

High-level meetings between the responsible government personnel, including the contracting officer and the general counsels of the Department of Defense and of the Navy, and Contractors, including the Chief Executive Officers of McDonnell Douglas and General Dynamics, occurred on December 18 and 21. During these meetings, Contractors asserted that they "[c]an't get there if we don't change contract," *id.* at 16,533, and "[i]t has got to get reformed to a cost type contract or we cannot do it." *Id.* at 16,549. When asked by the government on December 21 "can you correct deficiencies to provide an aircraft that meets the requirements," Contractors replied "[a]ll deficiencies cannot be corrected. Can we deliver a satisfactory aircraft for the Navy? Mother nature won't allow correction of all defects. We'll do the best we can and the Navy has to decide if that's good enough." *Id.* at 16,548-49.

Contractors responded to the cure notice on January 2 by admitting that they "[would] not meet delivery schedules or certain specifications of the original contract, or the revised FSD delivery schedule." *Id.* at 18,175. Contractors did not contest that they had failed to fabricate parts in time to meet the delivery schedule for the FSD aircraft. Nonetheless, Contractors asserted that they were not in default because, in their view, the delivery schedules were invalid or unenforceable. *See id.* at 18,175-78. As suggested cure, Contractors submitted a proposal to restructure the contract, pursuant to which Contractors would absorb a $1.5 billion fixed loss on the

cost overrun from the contract, the contract would be restructured to a cost reimbursement contract, and Contractors would waive their claims for equitable adjustment. Contractors proposed to restructure the contract pursuant to Pub.L. No. 85-804, which gives the President of the United States the power to authorize departments or agencies connected with national defense to grant extraordinary relief under contracts if such an action facilitates the national defense. *See* 50 U.S.C. § 1431 (1994).

On Saturday, January 5, Secretary Cheney met with Undersecretary of Defense for Acquisition Yockey, the Secretary of the Navy, and the Chairman of the Joint Chiefs of Staff to discuss the budget and the A-12 program. At the meeting, Secretary Cheney noted that a scheduled payment of $553 million – one of the largest installment payments under the A-12 contract – was due on Monday, January 7. Later that day, Secretary Cheney, acting under authority pursuant to Pub. L. No. 85-804, decided not to grant relief. On Sunday, January 6, Undersecretary Yockey informed Rear Admiral William R. Morris, who at this time was acting as contracting officer over the A-12 contract, that Secretary Cheney had denied 85-804 relief and that no further funds would be obligated under the A-12 program. The next day, Admiral Morris issued the termination letter to Contractors stating that the government was terminating the A-12 contract due to Contractors' default.

B

On February 5, 1991, the Navy sent a letter to Contractors demanding the return of approximately $1.35 billion in unliquidated progress payments under the terminated contract. On June 7, Contractors filed suit in the United States Court of Federal Claims under the Contract Disputes Act, 41 U.S.C. § 609(a) (1994), requesting that the court: (1) grant their equitable adjustment claims dated December 31, 1990, (2) convert the government's termination for default into a termination for convenience, (3) deny the government's demand for return of progress payments, (4) award Contractors costs and a reasonable profit under the contract, (5) award them settlement expenses, and (6) award damages for breach of contract. *See McDonnell Douglas Corp. v. United States,* 25 Cl. Ct. 342, 346 (1992).

After several years of litigation in the Court of Federal Claims, that court ruled, in a decision dated April 8, 1996, that the government's default termination was invalid according to *Schlesinger v. United States,* 182 Ct. Cl. 571, 390 F.2d 702 (Cl. Ct. 1968). *See McDonnell Douglas IV,* 35 Fed. Cl. at 368-71. The trial court held that under *Schlesinger,* the government is required to exercise "reasoned discretion" before terminating a contract for default, and that the government failed to meet this requirement because the Secretary of Defense's actions effectively forced the Navy to terminate the A-12 contract for default. *See id.* at 369-71. Therefore, the trial court vacated the government's termination for default and

converted it into a termination for convenience. *See id.* at 361.

In further litigation over damages, Contractors claimed that they were entitled to recover a reasonable profit under the contract, whereas the government argued that any recovery should be reduced by an appropriate loss-adjustment ratio. Contractors further alleged that the government possessed knowledge regarding how difficult it would be to perform the A-12 contract, and that under the "superior knowledge" doctrine, the government had a duty to either disclose such knowledge or otherwise protect Contractors against suffering unreasonable losses under the contract. The court held that the government's claim for a loss adjustment, Contractors' claim for reasonable profits, and the superior knowledge claim could not be further litigated because of the government's invocation of the "state secrets doctrine," *see McDonnell Douglas Corp. v. United States*, 37 Fed. Cl. 270, 272 (1996) (hereinafter *McDonnell Douglas V*), which grants the Executive the exclusive right to bar discovery into specific classified areas that affect state secrets. *See United States v. Reynolds*, 345 U.S. 1, 7, 97 L. Ed. 727, 73 S. Ct. 528 (1953). The court ultimately denied the government's claim for return of $1.35 billion in unliquidated progress payments, and allowed Contractors total costs under the contract of approximately $3.88 billion. Taking into account progress payments of some $2.68 billion that had already been paid to Contractors, the court entered judgment of approximately $1.2 billion

in favor of Contractors. *See McDonnell Douglas IX*, 40 Fed. Cl. at 555-56.

The government appeals from the trial court's decision to convert the default termination to a termination for convenience, and from the trial court's refusal to apply a loss-adjustment ratio in calculating damages. Contractors conditionally cross-appeal the trial court's ruling, arguing that the government has no power to terminate an incrementally-funded contract for failure to make progress toward a goal that has not yet been funded. Contractors also assert that their recovery cannot be reduced by a loss-adjustment factor based on the estimated cost of completing work that was never funded. We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3).

II

The level of discretion that must be exercised by the government before terminating a contract for default is a question of law, which we review *de novo*. *See Darwin Constr. Co. v. United States*, 811 F.2d 593, 596 (Fed. Cir. 1987); *Barseback Kraft AB v. United States*, 121 F.3d 1475, 1479 (Fed. Cir. 1997). We will upset the trial court's factual findings, however, only if they are clearly erroneous. *See, e.g., Bass Enters. Prod. Co. v. United States*, 133 F.3d 893, 895 (Fed. Cir. 1998).

A

The trial court held that the government's termination of the A-12 contract did not comport with the rule laid down in *Schlesinger* by the United States Court of Claims, our predecessor court, for a proper default termination. *Schlesinger* involved a cap manufacturer who won a contract to supply the Navy with 50,000 service caps for enlisted men. The contract required the manufacturer to submit pre-production samples of component materials, as well as two samples of the completed cap, to the government for approval prior to production. In addition, the contract included a delivery schedule which set forth delivery dates for five separate installments of the completed caps. *See Schlesinger*, 390 F.2d at 703-04. Schlesinger did not submit the two sample caps and certain thread for pre-production approval, perhaps because he had fulfilled a contract for 240,000 identical Navy caps the previous year. Schlesinger also failed to deliver the first installment of caps as specified in the delivery schedule. *See id.* At the time, Schlesinger was also a prime suspect in an ongoing United States Senate subcommittee investigation regarding textile procurement irregularities within the military. Indeed, Schlesinger testified before the subcommittee during the pendency of his supply contract; shortly after his testimony, the chairman of the subcommittee sent a letter to the Navy implying that Schlesinger's contract should be terminated. This information was communicated to the contracting

officer, who promptly terminated Schlesinger's contract. *See id.* at 705-06.

The Court of Claims held that the default termination of Schlesinger's contract was illegal. In doing so, the court first found that Schlesinger was indeed technically in default under the terms of the contract. *See id.* at 706-07. However, the court determined that neither the contracting officer nor anyone else in the Navy exercised independent judgment in terminating the contract for default. *See id.* at 707-08 (citing *John A. Johnson Contracting Corp. v. United States,* 132 Ct. Cl. 645, 132 F. Supp. 698, 704-05 (Ct. Cl. 1955)). Thus, the court found that the contractor's "bare" or "technical" default "served only as a useful pretext for the taking of action felt to be necessary on other grounds unrelated to the [contractor's] performance. . . ." *Id.* at 709.

The illegality in *Schlesinger* stemmed from the Navy's reliance on contractor default as a pretext to terminate its relationship with the contractor, independent of the state of actual performance under the contract. The court characterized Schlesinger's performance shortcomings as merely a "technical default" or "bare default," *id.* at 707, 708, and emphasized the Navy's total failure to consider the level of performance once it found a means for terminating by default. *See, e.g., id.* at 708 ("[T]he Navy acted as if it had no option but to terminate for default . . . once the mere fact of non-delivery was found."). In *Schlesinger,* it was improper for the Navy to terminate the contractor for default due solely to

pressure from a congressional oversight committee because this ground for termination was totally unrelated to contract performance.

In short, *Schlesinger* bars only a termination for default in which there is no considered *nexus* between the default termination and the contractor's performance under the contract. A second case relied upon by Contractors, *John A. Johnson Contracting Corp. v. United States,* 132 Ct. Cl. 645, 132 F. Supp. 698 (Ct. Cl. 1955), also supports this rule. In *Johnson,* the plaintiff contractor failed to complete construction for Army hospital buildings in a timely fashion because of bad weather that had rendered certain construction roads unusable. The construction roads had previously been contracted out to a different contractor. *See id.* at 699-700. After numerous delays, the contracting officer determined that both the roads and buildings should be completed by a single contractor, and therefore decided to terminate the plaintiff's contract. Although the contracting officer intended to terminate the plaintiff's contract for convenience, he ultimately terminated the contract for default because government lawyers informed him that a nondefault termination would create legal problems. *See id.* at 705. Because the *Johnson* court found that the contracting officer had already decided to terminate the plaintiff for convenience, it held that the change to a termination for default "did not represent [the contracting officer's] judgment as to the merits of the case." *Id.* Indeed, because the court found, as a factual matter, that the plaintiff could not

be held at fault for the unforeseen conditions, *see id.* at 703-04, there could be no proper nexus between a termination for default and the plaintiff's performance.

A third case cited to us by Contractors, *Darwin Construction Co. v. United States,* 811 F.2d 593 (Fed. Cir. 1987), further confirms the rule identified above. In *Darwin,* we adopted the Armed Services Board of Contract Appeals's finding that "the default action was taken solely to rid the Navy of having to deal with Darwin." *Id.* at 596 (internal quotation marks omitted). Thus, we held that the government used Darwin's technical default as a mere pretext for terminating the contract on grounds unrelated to performance. *See id.* Furthermore, *Darwin* clarifies what is meant by the "reasonable discretion" test used in *Schlesinger* and *Johnson.* In *Darwin,* we stated that, although a contracting officer has discretion with respect to contract termination, a termination for default will be set aside if it is arbitrary or capricious, or constitutes an abuse of the contracting officer's discretion. *See id.* at 598. When there is no nexus between the decision to terminate for default and contract performance, as was true in *Darwin, Schlesinger,* and *Johnson,* the termination for default may be arbitrary and capricious and set aside in favor of a termination for convenience.

Properly understood, then, *Schlesinger* and its progeny merely stand for the proposition that a termination for default that is unrelated to contract performance is arbitrary and capricious, and thus an

abuse of the contracting officer's discretion. This proposition itself is but part of the well established law governing abuse of discretion by a contracting official. *See, e.g., United States Fidelity & Guaranty Co. v. United States,* 230 Ct. Cl. 355, 676 F.2d 622, 630 (Ct. Cl. 1982) (listing four factors to be used in determining if conduct by a government official is arbitrary and capricious: (1) evidence of subjective bad faith on the part of the government official, (2) whether there is a reasonable, contract-related basis for the official's decision, (3) the amount of discretion given to the official, and (4) whether the official violated an applicable statute or regulation).

B

The record shows that the government's default termination was not pretextual or unrelated to Contractors' alleged inability to fulfill their obligations under the contract. Therefore, unlike the cases cited above, the government's decision to terminate the A-12 FSD Contract for default was related to contract performance, and the Court of Federal Claims erred by converting the termination into one for convenience without first addressing the question of breach.

First, the trial court interpreted the Navy's actions prior to termination to evince a desire *not* to terminate the A-12 program for default, but rather to continue the contract. *See McDonnell Douglas IV,* 35 Fed. Cl. at 370. For example, the trial court noted

that the government had overlooked Contractors' alleged default for several months, had unilaterally modified the contract to excuse the missed delivery date for the first aircraft, and had determined that even though the aircraft would be overweight, it would still meet operational requirements. *See id.* at 370, 373-74. Moreover, the trial court noted that the Navy "did not contemplate issuing a cure notice in December [1990]" and "did not believe the contractors' performance justified termination." *Id.* at 370.

The trial court's factual findings do in fact establish that the Navy did not want to terminate the A-12 program. Instead, at all times up until the very end, the Navy hoped to preserve the program and its A-12 aircraft. That is not to say, however, that Contractors were not in default under the contract, or that the government did not have the right to terminate the contract for default. A party to a contract, faced with a breach by the opposing party, can choose either to terminate the contract or to continue the contract, perhaps extracting other concessions or consideration from the breaching party in return for its willingness to modify the contract. *See, e.g.,* 3 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 7:36 (4th ed.1992). A party that chooses to proceed with the contract – even if it is the government, and even if it manifests a strong desire to procure the item that is the subject of the contract – does not thereby waive its right to terminate for default. Indeed, the trial court's finding that the Navy went to

great lengths to preserve the A-12 program suggests that it would not have terminated the contract but for its belief that Contractors had breached the contract or would not perform the contract.

More importantly, however, the record demonstrates that the government properly terminated the A-12 program for reasons related to contract performance. Admiral Morris, the contracting officer, testified at length about his decisional process that led to the termination for alleged default. He thought that he had three choices: to terminate for convenience, to terminate for default, or to do nothing. He rejected the latter as "irresponsible," thus focusing his attention on the other two choices. He eliminated the termination for convenience first, because he believed Contractors to be in material breach of the contract. This was so, in his words, because, as conceded in Contractors' response to the cure notice:

> They were in default because they acknowledged they would not be able to achieve the contract specifications and the contract requirements. Two, they had indicated that the would not be able to meet the delivery schedule that was currently in the contract. And three, they would not be able to perform the contract without extraordinary relief or additional funding for the contract. So they basically said they can't perform under the contract and they were in default of it.

Joint Appendix at 3,898-99. In further elaboration of his decision, again in the context of Contractors'

response to the cure notice, Admiral Morris testified as to why he thought Contractors' default was material:

> They had failed to fabricate parts so as to endanger performance of the contract, and in my judgment, as would relate to the production options, failed to make progress, and it was clear to me that that is where they stood on the 7th of January when I terminated the contract for default.

Id. at 3,917. As to why a termination for convenience was inappropriate, Admiral Morris stated that:

> Because I felt very strongly that as a result of the contractors' default, it would be nothing short of unconscionable for me to put the burden of the contractors' failure to make progress and the contractors' failure to fabricate parts, so as to endanger performance of the contract, put that burden on the government and the taxpayer to reimburse all costs and to pay the contractors a profit for their failures.

Id. at 3,920. Therefore, Admiral Morris terminated the contract for failure to make progress and for failure to meet contract requirements.

Failure to meet contract specifications and inability to meet the contract delivery schedule are of course relevant considerations to whether a contractor is in default. *See Discount Co. v. United States,* 213 Ct. Cl. 567, 554 F.2d 435, 441 (Ct. Cl. 1977) (inability to meet specifications); *Universal*

Fiberglass Corp. v. United States, 210 Ct. Cl. 206, 537 F.2d 393, 398 (Ct. Cl. 1976) (failure to meet schedule); *see generally* John Cibinic, Jr. & Ralph C. Nash, Jr., Administration of Government Contracts 929-35 (3d ed. 1995) (discussing the requirements for a default termination based on failure to make progress); *id.* at 953-60 (discussing anticipatory repudiation by a contractor, such as "nonperformance and claims for payments or relief from matters as to which the contractor had assumed the risk").

The trial court also found that Secretary Cheney denied extraordinary relief, which led to the termination, because of concerns about the A-12 program's "cost and schedule." *McDonnell Douglas IV,* 35 Fed. Cl. at 372. The cost to complete a contract – more particularly, the inability of a contractor to perform a contract at the specified contract price – and the ability to meet a contract schedule are both fundamental elements of government contracts and are related to contract performance; as such, they are highly relevant to the question of default.

The government had specific concerns about when – and if – the A-12 aircraft would ever be delivered and how much it would cost. Secretary Cheney stated in testimony before Congress that the A-12 program was terminated because "no one could tell me how much the program was going to cost even just through the full-scale development phase or when it would be available. Data that had been presented at one point a few months ago turned out to be invalid and inaccurate." *Hearings on National*

Defense Authorization Act for Fiscal Years 1992 and 1993 – H.R. 2100 and Oversight of Previously Authorized Programs Before the House Comm. on Armed Servs., 102nd Cong. 60 (1991) (statement of Richard Cheney, Secretary of Defense). The evidence in the record demonstrates that the Secretary of Defense denied relief under Pub. L. 85-804, and Admiral Morris chose to terminate the contract for default, for reasons related to Contractors' state of performance of the contract. The trial court emphasized that although Contractors failed to meet the aircraft weight limit, the Navy essentially waived this requirement because the overweight aircraft would still meet all operational requirements. *See McDonnell Douglas IV*, 35 Fed. Cl. at 363, 376. However, although that finding is relevant to the ultimate determination of whether Contractors were in breach, or whether a breach was excused, it is insufficient to show, in light of all the other evidence in the record, that the government terminated the contract for reasons wholly unrelated to contract performance.

We think it clear beyond any doubt that Admiral Morris, unlike the contracting officer in *Schlesinger*, or in other cases that have upset terminations for default for lack of nexus to contract performance behavior, made his choice for reasons related to contract performance. Admiral Morris certainly knew that Contractors took another view of events transpiring during contract performance: although they admitted that they could not perform the contract according to its terms, they felt that the fault for their failure

should be laid at the government's feet. Admiral Morris meant not to take away the right of Contractors to assert their defenses to termination for default, he instead only meant to assert the government's right to allege material breach on the record of contract performance that had been laid before him by Contractors themselves. Given the reasons stated for the action taken by the contracting officer in this case, it was legal error for the trial court to see these facts as commanding conversion of the termination for default into one for the convenience of the government.

To summarize, the government may not use default as a pretext for terminating a contract for reasons unrelated to performance; instead, there must be a nexus between the government's decision to terminate for default and the contractor's performance. The record and the facts found by the trial court establish that the government denied additional funding for the A-12 program and terminated the contract for default because of concerns about contract specifications, contract schedule, and price-factors that are fundamental elements of contract performance. Therefore, the trial court erred by vacating the termination for default without first determining whether a default existed. On remand, if the government can establish that Contractors were in default, then the termination for default would be valid. *See Lisbon Contractors, Inc. v. United States,* 828 F.2d 759, 765 (Fed. Cir. 1987) (holding that the government bears the burden of proof with respect to

the issue of whether termination for default was justified). Conversely, if the government is not able to make this showing, then the default termination was invalid and Contractors would be entitled to a suitable recovery, presumably under a termination for convenience theory.

III

We turn next to the government's argument that the trial court erred in refusing to apply a loss ratio to Contractor's termination for convenience recovery, and the trial court's related treatment of Contractors' claims under the superior knowledge theory and for reasonable profits. In government contracts law, under certain circumstances the government owes a duty to disclose critical information to a contractor that is necessary to prevent the contractor from unknowingly pursuing "a ruinous course of action." *Helene Curtis Indus., Inc. v. United States*, 160 Ct. Cl. 437, 312 F.2d 774, 778 (Ct. Cl. 1963). This doctrine of superior knowledge is well established in law, *see, e.g., Hardeman-Monier-Hutcherson v. United States*, 198 Ct. Cl. 472, 458 F.2d 1364, 1371-72 (Ct. Cl. 1972); *Helene Curtis Indus.*, 312 F.2d at 778 & n.1, and failure to disclose crucial information can lead to a finding of contract breach by the government, *see, e.g., GAF Corp. v. United States*, 932 F.2d 947, 949 (Fed. Cir. 1991). In this case, the government resisted Contractors' superior knowledge claims on the ground that the government could not have an implied duty to reveal classified information pertinent to the A-12

program that would threaten national security. The trial court denied the government's motion to dismiss the superior knowledge claims on the pleadings and allowed Contractors limited discovery. *See McDonnell Douglas V*, 37 Fed. Cl. at 275-76.

After a series of security breaches and discovery abuses, the trial court concluded that it could not litigate further the related issues of loss adjustment, superior knowledge, and reasonable profits. *See id.* at 272, 276-78. Contractors do not directly appeal this ruling; they contend only that if we upset the trial court's decision on loss adjustment, a remand of all three is appropriate. The government argues that Contractors' superior knowledge and reasonable profits claims were properly removed from litigation because they jeopardized state secrets, but that its loss adjustment claim could be litigated without this danger and should have been allowed to proceed. Because we conclude that the trial court erred in converting the government's default termination of the A-12 FSD Contract to a termination for convenience, whether a loss adjustment applies to termination for convenience damages is not ripe for our decision. Because of the passage of time and of possible intervening developments, we are in no position to judge whether the risk of disclosure of state secrets will preclude adjudication, on remand, of Contractors' superior knowledge claim, and the issues of loss adjustment and reasonable profit. We think the trial court must be free to adjudicate the government's defense of its termination for default in the manner

most fair and just to the parties. The trial court thus is free to reconsider this issue on remand. We express no view on the trial court's previous ruling on whether these three interrelated issues may be litigated.

IV

Turning finally to Contractors' cross-appeal, we consider whether the nature of the A-12 contract as a fixed-price, incrementally-funded contract affects the government's ability to terminate the contract. Contractors first argue that the government cannot apply a loss adjustment factor, based on the estimated cost of completing the contract, to Contractor's recovery under a termination for convenience because the government was not obligated to fund the contract to completion. Because we reverse the trial court's conversion of the default termination to a termination for convenience, we do not address this point.

Contractors similarly argue that the government cannot legally terminate the A-12 FSD Contract for failure to make progress toward work that the government was not obligated to fund, and which it in fact did not fund in full. Contractors argue that because the government limited its potential liability to Contractors through the incremental funding arrangement, *see* A-12 FSD Contract, PH-7(c), Joint Appendix at 15,073, there was no mutuality of obligation for the full FSD contract, and the contract was only valid to the extent of the funds already

obligated. Under Contractors' theory, it follows that the government could not terminate the contract for failure to make progress toward work that they were not legally obligated to perform. In essence, Contractors assert that the government was precluded from terminating them for default due to failure to make progress toward the completion of the A-12 contract, unless and until the government had funded the contract in full.

We reject Contractors' arguments, however, for the following reasons. First, the A-12 FSD Contract explicitly recites the grounds upon which the government may terminate the contract for default, which grounds include Contractors' failure to make progress. *See* 48 C.F.R. § 52.249-9(a)(1)(ii) (1984); A-12 FSD Contract § I P I, Joint Appendix at 15,251 (incorporating FAR 52.249-9). Contractors agreed to installment funding of the contract because the government could not obligate the full ceiling price at the time of contracting. *See id.* § H-7(a), Joint Appendix at 15,072. In order to comply with the Anti-Deficiency Act, *see* 31 U.S.C. § 1341(a) (prohibiting expenditures, obligations, and contracts exceeding appropriations), the parties specified that the government's total obligation, including termination costs, would never exceed the amount obligated at the time of termination. *See* A-12 FSD Contract § H-7(c), Joint Appendix at 15,073. In return, Contractors were not required at any time to incur costs in excess of the total obligated amount. *See id.* § H-7(b), Joint Appendix at 15,072. Despite this funding arrangement,

however, the parties agreed that the government had the right to "terminate this contract in whole or in part if the Contractor fails to . . . prosecute the work so as to endanger performance of this contract." 48 C.F.R. § 52.249-9(a)(1)(ii) (1984). Therefore, installment funding did not contractually manifest itself as a condition to Contractors' performance; it merely stated a term characterizing the performance of the government. Moreover, the terms of the contract make clear that failure to make progress was a valid basis for default termination.

Second, we disagree with Contractors regarding their obligations under the A-12 FSD Contract. Contractors emphasize that, because of the incremental funding, there has never been a binding contract for completion of full FSD performance. Contractors acknowledge that the government could have default terminated the contract for failure to meet specific requirements associated with a particular installment of funding, but assert that failure to meet such specific requirements constitutes the *only* basis for a valid default termination. Because the contract did not link any specific objectives to a particular level of funding, Contractors argue, there was no basis for a default termination. We agree with Contractors that, at the time of termination, they were not obligated to *complete* all contract requirements. That does not mean, however, that Contractors did not have any obligations with respect to the full FSD requirements. As we noted above, the A-12 FSD Contract recites failure to make progress as a basis for contractor

default and contract termination. *See* 48 C.F.R. § 52.249-9(a)(1)(ii) (1984). Therefore, Contractors' assertion that failure to meet contract requirements that are linked to already-funded work is the sole basis for default is simply incorrect. Failure to satisfy such requirements forms a ground for default under 48 C.F.R. § 52.249-9(a)(1)(i) (stating that the government may terminate a contract for default if the contractor fails to "perform the work under the contract within the time specified in this contract or any extension"). Subsection (a)(1)(ii), in contrast, provides a separate basis for default: it obligates Contractors to make enough progress so that contract performance is not endangered. *See Universal Fiberglass Corp.*, 537 F.2d at 398 (Ct. Cl. 1976) ("Failure to make progress is obviously something different from failure to deliver, or else the default clause would not provide separately for both."). The A-12 FSD Contract makes clear that this is a continuing obligation that exists even though the contract has not yet been funded to completion.

Third, the authorities cited by Contractors fail to establish that they were under no contractual duty to make progress. Contractors rely heavily on an internal government memorandum prepared by the Defense Department's Contract Finance Committee to support their proposition that a fixed-price incrementally funded contract imposes no obligations on a contractor beyond those associated with funding that has already been provided. The memorandum expresses the committee's view that:

> *If incremental funding is used, the contractor cannot be required to expend any effort beyond the Government's limitation of obligation.* Failure to provide additional funding increments not only results in contract termination, but also makes it necessary to define, after the fact, what part of the effort should have been completed for the amount of funding actually provided. Since this division was apparently not possible in the first place, the contract, for all practical purposes, is converted to a best effort cost-type vehicle; the Government gets whatever the contractor was able to complete with the money provided. . . . Any advantages gained from use of a fixed price R & D contract are at risk until that point when incremental funding is replaced with full funding.

Memorandum from Chairman, Department of Defense Contract Finance Committee, to Director, DAR Council P 3(c) (June 5, 1992), Joint Appendix at 68,695 (emphasis added). Setting aside questions about the legal significance of this memorandum, we conclude that Contractors' duty to make progress toward completing the A-12 FSD contract is consistent with the views expressed in the memorandum. Unlike the obligation to complete performance, which arises only when the contract has been fully funded, Contractors' duty to make progress is a continuing obligation associated with each payment installment, and thus is not an "effort beyond the Government's limitation of obligation." *Id.*

Having determined that Contractors were obligated to make enough progress such that contract performance was not endangered, we must now address what progress Contractors should have made, corresponding to the funding actually provided by the government, in order to avoid default for failure to make progress. We disagree with Contractors' argument that it is "not possible" to answer this question, and that the contract must be converted into a cost-reimbursement type contract. *Id.* In litigation over a contractor's failure to make progress – unlike a dispute over failure to meet a specific contract requirement or schedule – courts must always determine *ex post* the threshold of performance that a contractor must meet to avoid endangering performance of a contract. *See* Cibinic & Nash, Administration of Government Contracts 930-32 (tracing the evolution of the test applied by courts for failure to make progress). The same is true in this case.

Contractors rely on *Electronics of Austin,* 1986 ASBCA Lexis 606, ASBCA No. 24,912, 86-3 B.C.A. (CCH) P19,307 (1986), for the proposition that they were under no duty to make progress. In that case, the Board of Contract Appeals found that the government had waived the original contract performance schedule and therefore "there was no time frame within which [the plaintiff] had to perform." *Id.* at 97,631. Because there was "no time frame" at all for performance, the Board held that the plaintiff could not be guilty of failing to make progress. *Id.* In the instant case, however, there was a specified delivery

schedule, including the delivery of the first FSD aircraft in December 1991. *See* A-12 FSD Contract § F, Joint Appendix at 15,049 (initial delivery schedule for the eight FSD aircraft); Contract Modification P00046 P 1(b), Joint Appendix at 15,657 (Aug. 17, 1990) (revised delivery schedule). Therefore, the contract imposed a duty on Contractors to make such progress so as not to endanger performance as long as the contract was in place, that is, as long as the contract was being funded. *See* 48 C.F.R. § 52.249-9(a)(1)(ii) (1984). Consequently, Contractors' protestations to the contrary, we do not "view the contract that existed prior to full funding as embodying the 'ultimate end item' of the full FSED effort." Reply brief of Plaintiffs-Cross Appellants at 6. Instead, we hold only that the contract, throughout its term, embodied a duty to make progress toward the ultimate end item.

The question of whether Contractors satisfied their duty is of course that of breach, and must be determined by taking into account all of the relevant facts and testimony, such as Contractors' statements that they could not meet the contract specifications, the contract delivery schedule, nor complete performance at the specified contract price. *See supra* Part II.B. We leave it to the trial court to resolve these issues in the first instance.

CONCLUSION

We reverse the trial court's ruling that the government's default termination of the A-12 FSD

Contract must be converted into a termination for convenience because the government did not exercise the necessary discretion. Of course, we do not hold today that the government's default termination is justified. As Contractors correctly point out, they have never been found to be in default of the contract. Because the trial court focused on the legitimacy of the government's default termination decision, rather than on whether Contractors were in fact in default, the parties have not yet been afforded the opportunity to fully litigate default. *See McDonnell Douglas Corp. and General Dynamics Corp. v. United States,* No. 91-1204C, slip op. at 2 (Fed. Cl. June 17, 1993). If the government fails to establish at trial that Contractors were in default under the contract, then the government's default termination would be improper and Contractors could rightfully recover damages under the theory of a termination for convenience. We vacate the trial court's ruling that the government's loss adjustment claim and Contractors' superior knowledge claim and claim for profits may not be litigated. Finally, we reject Contractors' argument that the incremental funding found in the A-12 FSD Contract precludes the government from terminating the contract for failure to make progress.

REVERSED-IN-PART, VACATED-IN-PART, AND REMANDED.

MCDONNELL DOUGLAS CORPORATION, AND GENERAL DYNAMICS CORPORATION, Plaintiffs v. UNITED STATES OF AMERICA, Defendant.

No. 91-1204C

UNITED STATES COURT OF FEDERAL CLAIMS

76 Fed. Cl. 385; 2007 U.S. Claims LEXIS 140

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JUDGES: Robert H. Hodges, Jr., Judge.

OPINION BY: Robert H. Hodges, Jr.

OPINION

ORDER AND OPINION

HODGES, Judge.

The United States contracted with McDonnell Douglas and General Dynamics to design and build stealth aircraft for the Navy, then abruptly terminated the contractors for default. The contractors sued to convert the default to termination for convenience of the Government. The A-12 contract was technically complex, as might be expected of a major new weapons system, and the parties anticipated many years of development. The projected cost exceeded $ 4 billion in the initial stages. The purpose of the Full-Scale Engineering and Development (or FSED) contract was to design, develop, manufacture, and test eight A-12 aircraft. The eighth plane would serve as a prototype for subsequent production aircraft. Upon successful completion of the FSED effort, the Government could direct plaintiffs to begin a production phase. A series of options authorized the A-12 production phase in the contract by which the Government could purchase production "Lots" of aircraft. At termination, the Navy had exercised its contractual right to order six production aircraft, known as Lot I.

Almost from the beginning, the contractors encountered problems that caused them to fall behind schedule. McDonnell Douglas and General Dynamics were to deliver the first test aircraft in June 1990. It became apparent well before then that the contractors

would not meet that schedule. The first test aircraft was a key milestone in development of the A-12 known as first flight. The parties were unable to agree on rescheduling first flight and the succeeding seven aircraft of the FSED phase. The Navy extended the delivery dates unilaterally to accommodate the delayed prototypes. This unilateral modification of the contract's schedule was designated P00046. P00046 lies at the heart of this dispute.

The issue on remand is "whether the Government's default termination was justified." *McDonnell Douglas Corp. v. United States*, 323 F.3d 1006, 1014 (Fed. Cir. 2003). FAR 52.249-9 describes the Government's authority to terminate a research and development contract for default. That section authorizes the Government to terminate a contract if the contractor fails to "prosecute the work so as to endanger performance of th[e] contract." FAR 52.249-9(a)(1)(ii).

We review defendant's default termination according to the "*Lisbon* standard." *McDonnell Douglas*, 323 F.3d at 1015; *see Lisbon Contractors, Inc. v. United States*, 828 F.2d 759 (Fed. Cir. 1987). The *Lisbon* standard permits termination for default if the Government demonstrates that the contracting officer had a reasonable belief "'that there was no reasonable likelihood that the contractor[s] could perform the entire contract effort within the time remaining for contract performance.'" *McDonnell Douglas*, 323 F.3d at 1016 (quoting *Lisbon*, 828 F.2d at 765). The Court of Appeals for the Federal Circuit emphasized the importance of "decid[ing] the actual

performance that the contract requires and the amount of time remaining for performance" before making that determination. *Id.* at 1017 (citing *Lisbon,* 828 F.2d at 766). In fact, the Circuit observed:

> Unless the contracting officer had determined the entire effort required under the contract and the time left to complete the contract, it would be difficult, if not impossible, for him to resolve whether there was no reasonable likelihood that the contractor could perform the *entire contract effort within the time remaining for contract performance.*

Id. (internal quotation marks and citation omitted). The parties disagree about the meaning of the Circuit's remand directing the court to apply the *Lisbon* test in this research and development contract.

The contractors urge the court to employ a strict interpretation of the Circuit's remand. That is, "the entire contract effort" must be all-inclusive, comprising the eight FSED aircraft, the six Lot I production aircraft and years of follow-on testing, aircraft maintenance, and contractor support for the Navy. Plaintiff McDonnell Douglas argues that no contracting officer could reasonably have terminated the A-12 contract for default for failure to make progress if he did not know the work left to be done and the time left to do it.

The Government offers a more flexible approach. The "entire contract effort" as used by the Circuit

represents a convenient and enforceable yardstick this court can use to evaluate the contractors' progress at termination. Time was of the essence in the A-12 contract, and plaintiffs had an obligation to make enough progress to insure performance was not endangered. This court should decide whether the weight of the evidence in the record shows that the contracting officer was reasonably justified in feeling insecure about the contract's timely completion.

Defendant's argument is important in that the size of the yardstick does not matter. That is, the "entire contract effort" need not include every segment of work envisaged by the contract, but may be any objective measure of the contractors' progress at termination. Defendant's suggestion that we use a reasonable yardstick to measure performance is attractive for its flexibility and its simplicity, but it may be foreclosed by earlier rulings of the Federal Circuit.

The A-12 contract did not define "the time remaining for contract performance," as plaintiffs have interpreted that phrase. The contract has no "time remaining for contract performance" as in supply, service, and construction contracts. Defendant cannot prevail if the law requires an enforceable contract completion date at termination. That is, if the date we must look to in measuring the contractors' progress can occur no earlier than after completion of plaintiffs' contract requirements, we would vacate the termination for default. *See Divecon Servs., LP v. DOC,* 2004-2 B.C.A. (CCH) P32,656 (2004) ("Without

a . . . specific completion date, the Government could not rationally terminate for default for failure to make progress, since there was no objective against which the contractor's progress could be judged."). The contracting officer did not know in January 1991 when contract completion might occur.

Defendant's burden of proof does not necessarily require the Government to provide a completion date for the entire contract effort, however. The FAR default provision does not refer to contract completion. The Circuit emphasized the importance of that requirement repeatedly, but the court also suggested other factors for consideration. Comparison of the percentage of work completed with the time remaining is only one consideration. *McDonnell Douglas,* 323 F.3d at 1016-17. The time remaining for performance is part of the "objective inquiry" under *Lisbon. Id.* Defendant's inability to establish a completion date for the A-12 contract does not compel a ruling for plaintiffs.

The ruling in this case depends on a discrete element of contract performance used as a yardstick to measure the contractors' progress at termination. The Navy's unilateral modification known as P00046 serves this purpose. The schedule for P00046 contained benchmarks for performance and enforceable delivery dates when termination occurred in January 1991; it represents the "entire contract effort" the Circuit requires for measuring performance. This yardstick enables the court to consider the contractors' progress

in light of factors that are probative of their ability and willingness to perform.

This Opinion also discusses "other factors usually relied on by courts and contract boards," for determining contractors' progress. *Id.* The contracting officer could have concluded that McDonnell Douglas and General Dynamics had "no reasonable likelihood" of delivering the aircraft on time as measured by the P00046 schedule. We must again uphold the Government's default termination of the A-12 contract.

I. BACKGROUND

The Government began development of the A-12 Avenger in 1984. The agreement between the Navy and the contracting team of McDonnell Douglas and General Dynamics was an incrementally-funded, fixed-price full-scale engineering and development (FSED) contract. Its purpose was to design, manufacture, and test eight A-12 prototypes. The Navy would use the prototypes to test various aspects of the aircraft's design; it maintained options to order production aircraft later.

The contract schedule required plaintiffs to deliver the first prototype in June 1990. Seven additional prototypes were due monthly through January 1991. The Navy exercised its option to purchase Lot I of the production models in May 1990, before the contractors were to deliver the first prototype. As it became clear the contractors would not make first flight in June 1990, the Navy issued a

unilateral contract modification in August 1990, extending first flight to December 1991. Known as P00046, the modification extended the seven additional A-12 prototypes through February 1993.

The United States terminated plaintiffs' contract for default in January 1991, nearly a year before the first flight was due.

A. THE A-12 CONTRACT

Plaintiffs' incentive contract had a target price of approximately $ 4.38 billion, and a ceiling price of $ 4.77 billion. The Government would pay forty percent of any costs over the contract price and below the ceiling price. The contractors would pay the remaining sixty percent, and all costs over the ceiling price.

The contract required the Navy to make payments in eleven installments from the date the parties signed the contract to the last payment on November 1, 1992. The terms of the installment payments were contained in Clause H-7 of the contract, which stated,

> (a) This financing arrangement is necessitated by the unavailability for obligation, at the outset of this contract, of sufficient funds to cover the total target values or ceiling price of the basic FSED contract line items.
>
> (b) The Contractor agrees that the Government's obligation of funds in the amounts and by the dates set forth below

> will permit compliance with the contract. The Contractor acknowledges that the terms and conditions of the performance of this contract have been established on the basis that the Contractor's termination liability will not exceed the amount set forth below by the dates set forth opposite said amounts. Nothing herein shall authorize nor require the contractor to incur costs, plus a reasonable allowance of profit, in excess of the total amount obligated at any given time. . . .
>
> (c) In the event the Government fails to obligate any specified installment by the time specified, the Contractor [ ] will continue performance of the contract only to the extent that he shall not be required to incur obligations (termination liability) beyond that amount already obligated by the Government. . . . The Government's total obligation for payment (including termination settlement expenses) under this contract shall not exceed the total amount obligated at the time of termination.
>
> . . .
>
> (e) Nothing contained in this clause shall affect the right of the Government to terminate this contract pursuant to either the "Default" or "Termination for Convenience of the Government" clauses.

The A-12 Program encompassed contract phases such as Concept Formulation, Full-Scale Development,

Demonstration/Validation, and Full Rate Production. The Navy obtained approval from the Defense Acquisition Board, or DAB, at each development phase. The Navy agreed to proceed with Full-Scale Development (FSED) after the Defense Acquisition Board approved the Demonstration/Validation phase in January 1988.

The contract required plaintiffs to design, build, and test eight A-12 prototypes, manage the work according to the contract schedule, and provide logistical support to the Navy.[1] Section B of the contract consisted of a series of Contract Line Item Numbers, or CLINs. Each was tied to a particular aspect of work. For example, CLIN 0001 was the ATA Aircraft Initial Design Review (IDR). The contract contained fifty-six CLINs, numbered 0001 through 0058, at a total cost of $ 4,379,219,436. Lot I production CLINs ranged from 0101 through 0133. Four CLINs were deleted eventually from the contract's requirements.[2]

[1] The Navy's solicitation stated: "The intent of the Navy is to procure under one contract, the design, fabrication, test, and evaluation efforts necessary to qualify the ATA Full Scale Development (FSED) aircraft for production."

[2] The Navy could have moved to the Full Rate Production phase if the contractors had built the eight prototypes. Therefore, Section B of the A-12 contract contained CLINs for the production options of the contract. Option Item 0101 was the six production aircraft in Production Option I, or Lot I. Lot I accounted for thirty-one additional CLINs. Option Item T0201 corresponded to eight production aircraft authorized by

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Section C of the A-12 contract contained the Work Statement. The CLINs in section C were divided among five areas of performance: design, manufacturing, testing, support, and management.

1. Design

The design phase called for a series of performance reviews to ensure that the A-12 design was progressing according to contract requirements. CLIN 0001 was Initial Design Review. This review assessed whether "the selected aircraft design approach [wa]s compatible with the engineering requirements of the contract." It was "a means of determining that the contractor[s] ha[d] correctly understood all aircraft design and test requirements."

CLIN 0002 was the Preliminary Design Review, which "evaluate[d] the progress, technical adequacy, and risk allocation (on technical, cost, and schedule bases) of the selected design approach and determine[d] its compatibility with performance and engineering requirements of the development specification." The contract stated that "completion and approval . . . of the final [Preliminary Design Review] w[ould] result in authorization for the contractor[s] to proceed with the design of the [aircraft]."

Production Option II, which contained thirty-two CLINs. Similar procedures applied to Options through Lot VI.

CLIN 0003 was Critical Design Review (CDR). CDR would occur "when detail design and analysis [wa]s essentially complete (90%)." This review sought to examine "the potential of the detailed design of the [aircraft] to satisfy the performance and engineering requirements of the [aircraft's] development specifications." Review at this level would take place over a number of sessions "consistent with the completion schedule for the individual design efforts." CLIN 0004 added, "[a]t the conclusion of the incremental CDRs a final CDR of approximately four working days will be held to summarize the results of the individual CDRs." The review program would be closed upon approval by the Navy of the final CDR. This would "result in authorization for the Contractor[s] to proceed with the design of the ATA aircraft." After approval of the design, the contractors would move on to manufacture.

2. Manufacturing

The contractors began the process of manufacturing the first prototypes after the Navy approved their design. The contract called for the "manufacture and furnish[ing of] eight (8) aircraft and associated mockups, models, and test articles in accordance with the Detail Specification for ATA Weapon System, SD-574-1."[3] Plaintiffs would develop Avionics Integration

[3] SD-574-1 is the "detailed Specification for Carrier Based Advanced Tactical Aircraft Weapon System." It outlines the

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Laboratories "as needed to provide a technically acceptable product within schedule."

The eight FSED prototypes would undergo careful ground and flight testing of nearly every aspect of the A-12's design. Each test aircraft would be more complex than the last. The ground testing requirements were set forth in an addendum to the contract, attachments 12-18. These were the "Contract Engineering and Test Requirements for the Advanced Tactical Aircraft Weapon System." Flight testing would evaluate the aircraft's propulsion systems and its ability to take off and land from carriers at sea. These and other technical aspects, would be monitored from first flight through completion of TECHEVAL. Attachments 18-22 of the contract contain detailed descriptions of these flight tests.

The testing phase was sequential, in that later tests were dependent upon successful completion of earlier testing efforts. Rigorous testing procedures did not end with the eight prototypes. Production aircraft produced in Lot I would be used to test various aspects of the plane's performance as well.

CLINs 0051 through 0056 were tied to Phases I through VI of the contractors' testing responsibilities.

A-12's technical specifications, which are contained in Attachments 2-11 in Section J of the contract.

Testing Phase VI overlapped with TECHEVAL,[4] the Navy's formal testing and evaluation program for the A-12. The purpose of TECHEVAL was to assure that the aircraft met technical requirements of the contract.

3. Testing

The A-12 contract provided that the Navy would monitor the contractors' progress during all phases of contract performance. CLIN 0005 stated that satisfactory completion of interim requirements would not occur until the Government approved the results of tests, inspections, or analyses of such requirements. This line item established joint Navy-contractor aircraft conferences and reviews. These conferences included the First Flight Readiness Review and the Production Readiness Review. Contract line items related to maintenance, support, and management programs were 0021, 0024, 0035, 0037, and 0049.[5]

[4] CLIN 0056 required the contractors to "conduct Phase VI of testing . . . as required to the completion of TECHEVAL on all TECHEVAL aircraft."

[5] Section E of the A-12 contract dealt with inspection and acceptance of the work by the Navy. With respect to FSED requirements, the contract stated,

> Initial Design Review (IDR) under Item 0001, Preliminary Design Review (PDR) under Item 0002 and Critical Design Review (CDR) under Item 0003 are not complete until these reviews on the entire

(Continued on following page)

The most important requirement of the contract for our purposes is schedule. Schedule is the reason the contracting officer gave for default terminating the contractors; it is the remaining basis for evaluating the contractors performance.

4. Schedule

The delivery schedules are in Section F of the A-12 contract. Performance deadlines could be derived either from the Master Program Schedule, by referring to other CLINs in the contract, or from assigned calendar dates. For example, the final FSED aircraft was due initially in January 1991, an assigned date. Derived dates included Item 0001, Initial Design Review, due "[n]ot later than 6 months after contract award." Item 0002, Preliminary Design Review was due "[n]ot later than 12 months after Contract Award." Item 003, Critical Design Review, would occur "18 Months after Contract Award."[6]

> aircraft have been completed and approved by NAVAIR (AIR-05), all action items have been closed (defined, with mutually acceptable resolution plans which specify a schedule and the party who has the action), and under CDR (Item 0003) the Lot IV proposal in accordance with clause H-22 has been received. Provisional acceptance of the first aircraft under Item 0005 will evidence completion of Item 0006. . . .

[6] The Navy awarded the A-12 contract on January 13, 1988. Tying the dates in Section F to the award date meant IDR would take place no later than June 13, 1988; PDR was due by

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The eight FSED aircraft provided for in Line Item 0005 were to be delivered on a schedule of approximately one per month beginning in June 1990. The final FSED aircraft would be delivered in January 1991, according to the original schedule. The FSED contract schedule originated from CLIN 0011, which stated,

> [t]he Contractor shall establish and maintain management activities in accordance with the Project Management Requirements for the ATA Aircraft Weapon system to satisfactorily complete the tasks required by this contract. The program management effort shall be established with authority delegated at appropriate levels. Individual assignments within the management organization shall facilitate single-points-of-contact for interface with Government Managers in a timely manner. The Contractor shall commit such resources as are necessary to accomplish the requirements stated herein. Program Management shall be accomplished in accordance with Attachment 24, the Program Management Requirements of the ATA

January 13, 1989, and CDR would begin June 13, 1989. Section F stated that "Critical Design Review (CDR) is not complete until CDR on the entire aircraft has been completed, all action items have been closed (defined with mutually acceptable resolution plans which specify a schedule and the party who has the action), and the Lot IV proposal in accordance with clause H-22 has been received."

Aircraft Weapon System, . . . and Attachment 25.

The A-12 contract required plaintiffs to prepare a Master Schedule to "include all critical activities necessary to complete the work required by the contract" and the important Navy milestones defined in Attachment 25. Upon approval by the Government, the Master Program Schedule would be the "baseline schedule against which progress will be measured." Plaintiffs provided the Master Program Schedule in their Best and Final Offer, and updated the Master Schedule periodically. Their last update prior to contract termination was August 20, 1990.[7]

[7] Attachment 24 to the Contract included the following:

> 2.2 *Master Program Schedule.* The Contractor shall prepare a Master Schedule for the ATA Project. This schedule shall include all critical activities necessary to complete the work required by the contract. Critical paths shall be highlighted and sensitivity to changes in schedule or resource availability identified. Required government activities shall be included in the schedule, and any critical actions identified. Following joint Program Office and Contractor review and concurrence, this schedule shall become the Master Program Schedule, and will become the baseline schedule against which project progress will be measured.

Attachment 25 identified the following critical milestones:

Milestone	Date
FSED Start	December 1987
First Flight	June 1990

(Continued on following page)

5. Other Contract Provisions

The A-12 contract contained clauses from Federal Acquisition Regulations that routinely appear in fixed-price contracts such as this. The following provisions were incorporated by reference from FAR and applied to the FSED contract, CLINs 0001 to 0058:

FAR 52.232-2	Payments (Fixed-Price Research and Development);
FAR 52.232-16	Progress Payments;
FAR 52.232-17	Interest;
FAR 52.243-1	Changes-Fixed-Price;
FAR 52.249-2	Termination for Convenience of the Government; and
FAR 52.249-9	Default (Fixed-Price Research and Development).

Standard provisions for the production options were separate from the FSED portion of the contract. Most were the same, but the termination clause was

TECHEVAL	April 1993
OPEVAL	June 1993-November 1993
BIS Trial	June 1994
O Level	July 1994
IOC	July 1994
Support	March 1996

an important exception. The contract for production lots incorporated FAR default provisions for Fixed-Price Supply and Service contracts.

The parties agree that plaintiffs were to design, construct, and test the A-12, support the Navy in its tests of the aircraft, and manage work according to the contract schedule. They were to perform the work in a sequential fashion, so the projects would build on each other. The design phase came first, followed by production, then testing. The parties disagree about practically everything else.[8]

The Naval Air Command, referred to as NAVAIR, awarded the A-12 contract to General Dynamics and McDonnell Douglas on January 13, 1988. The contractors began work immediately.

B. CONTRACTORS' PERFORMANCE

Performance of the FSED contract on schedule was more difficult than expected for a number of reasons. No one had developed a stealth fighter with the A-12's flight capabilities. The science and technology required was state-of-the-art. The United States Air Force chose not to share its highly sensitive stealth information sufficiently to avoid

[8] The appeals court made reference to reopening the record, leaving that matter to the trial court's discretion. The parties agree that this court has all the information necessary to rule on the issues at hand. *See infra* note 54.

technical difficulties and delay.[9] The Air Force eventually made much of the needed information available but it was too late in the process, according to the contractors. The plaintiffs' progress in key areas of performance prior to termination are summarized in the following sections.

1. Design

The Navy conducted design reviews to assess plaintiffs' progress on the A-12 design. Critical Design Review was among the last steps in this process. Admiral John Lockard was responsible for overseeing the design reviews. He testified that Critical Design Review would "provide a sense of [whether] the requirement [would] be satisfied by the product in its detailed design state, [then] ensure that the product is producible; in other words, that [the contractors] could build them in a repetitive way such that . . . one airplane looks like the next airplane."

[9] Compartmented "state secrets" normally belong to and are controlled by government agencies rather than "the Government." Rules for handling so called Black Programs vary among the agencies. This tends to cause friction – in this case, between the Navy and the Air Force. As one example, the agencies' rules defining "need to know" are entirely different. The contractors wanted and needed highly sensitive technical information for the A-12, and the Navy wanted them to have it. This created many legal and logistical problems unrelated to the merits, and required substantial and frequent court involvement. Security personnel assigned to this court, our office of the Clerk of Court, and professionals attached to the Department of Justice, provided advice and assistance.

The CDR process offered the Navy an opportunity to raise lingering concerns about technical progress through Requests for Action, or RFAs. The Navy made 433 such requests. By the close of CDR, Admiral Lockard had signed all 433 Requests for Action. Admiral Lockard stated at trial that "[e]ach [RFA] had been signed by me, indicating that as far as I was concerned, I had reached agreement with the contractor." His signature provided evidence that the parties had resolved issues represented by Requests for Action.

Admiral Lockard closed the formal Design Review Board activity on October 22, 1990, and stated "[a] fair agreement has been reached, one which will provide the Navy with the product they need." He added, "[t]echnical resolution on the airplane" was accomplished as well. Admiral Lockard thought the Navy and the contractors were "in the process to a satisfactory conclusion of CDR." He wrote that the "product as defined [in the CDR activity] will meet [the Navy's] operational requirements."

At the same time, Admiral Lockard reported to Navy Secretary Gerald Cann a "lingering technical concern" on some design and production aspects. Admiral Lockard noted in particular that

> the tooling concept that was being used to build these very complex parts was one which there was much debate about. [C]ould that [concept] really produce [?] Until we could get some consistency, it was hard . . . to make a determination that, in fact, they

> could do this repeatedly at a production rate sufficient to produce parts to support a production line of so many per month.[10]

During the Count XVII trial, Admiral Lockard described the contractors' difficulty in manufacturing the major structural components of the aircraft, termed "big bones." He explained that it was the first time anyone had built a structure of this size, with the materials being used. The "big bones" were

> critical to the design – to the integrity of the airplane, and [the contractors] were not making progress in building these. As a matter of fact, they were severely behind and going further behind in building these parts, and we couldn't assemble the first airplane until they were able to build these parts successfully.

These were concerns expressed about the Admiral's findings at CDR. As termination approached, Admiral Lockard testified about

[10] Admiral Lockard's message to Secretary Cann was intended to convey the Navy's "need[ ] to ensure that [it] worked with the contractor to improve their ability to get yield from the parts in a predictable way, and if we didn't do that, then [the Navy and the contractors] weren't ready for production." Asked why production would not occur on time, Admiral Lockard responded, "[b]ecause you couldn't predict how much the airplanes were going to cost if you didn't know how long it was going to take to get the number of parts required to build it."

> almost daily meetings between Admiral Morris and myself, trying to figure out how we were going to be able to resolve this and keep this program on track. So we discussed all of the technical issues, could we get them resolved, if we could find a way to satisfy the business arrangements, to get the contractors to do the work, and we were certain that we could do it. We were unsuccessful in my discussions, though, at that point of finding a way to get the contractors to do the work.

When asked his assessment of the contractors' ability to manufacture composite parts at termination, Admiral Lockard responded,

> there was still an awful lot of uncertainty in the ability, particularly for General Dynamics. The tooling concept that they had chosen, I was very concerned that it was going to be able to produce parts in a repeatable fashion. They had not been able to stabilize it. I thought it was critical in nature, and I was concerned that it was going to take us more time to work that tooling concept out in order to have one that could produce with certainty parts that could be used on a continuing basis.

However, Admiral Lockard closed the formal Defense Review Boards because the technical problems had been resolved. He stated at adjournment that "[a] fair agreement has been reached, one which will provide the Navy with the product they need." The Admiral

concluded, "technical resolution of the airplane has been reached."

The contractors worked on the Program during and after the design reviews. Technical agreements between plaintiffs and the Navy caused the contractors to modify their work in some cases, often changing the agreements from original contract requirements. Officials from General Dynamics and McDonnell Douglas understood that the contract work should continue according to the agreements reached at CDR. When CDR closed, the parties had negotiated a critical path toward completion of the design and development of the aircraft.

Mr. Lamers of General Dynamics made the following announcement at an "all hands meeting" in November 1990:

> The critical design review is completed, this is the end of the . . . three major reviews that have been taking place over the last more than two years. Thirty-eight significant issues were resolved. We've closed 433 requests for action. . . . [a]nd it does constitute the Navy's formal approval [and] ratification of the design of the A-12.[11]

The Navy knew months prior to the final Critical Design Review that the A-12 would not meet some of

[11] The Government accepted plaintiffs' design just over a month before its decision to terminate plaintiffs for default for failure to make progress.

the technical specifications in the contract. Despite such knowledge, the Navy agreed that technical concerns had been addressed and resolved to its satisfaction. The Navy accepted plaintiffs' design for the A-12 in November 1990.[12] The next issue was whether the contractors could manufacture the plane according to the designers' intent.

2. Manufacturing

The contract required plaintiffs to "design, develop, manufacture and furnish eight (8) Full Scale Engineering Development (FSED) aircraft and associated mockups, models, and test articles in accordance with the Detail Specification for [the Advanced Tactical Aircraft] Weapon System. . . ." The contractors would employ a "building block" approach, building each succeeding prototype to be significantly more complex than the previous one. The first

[12] The Government contends that the court may not use the agreements reached at CDR as waiver of nonconformance by the Government because such agreements were not signed formally. The contractors maintain that the parties considered themselves bound by the agreements at that time, despite the lack of formal signatures. The issue is not whether the agreements are legally binding documents in any event. The agreements provide additional evidence that the Government had accepted plaintiffs' design. Moreover, government officials commented at trial that these "handshake agreements" had the weight of contractual force, and everyone intended to honor them. The Navy's relationship with plaintiffs was a solid and impressive one throughout. They worked together closely and both sides handled day-to-day affairs of the relationship honorably.

prototype would test the A-12's ability to fly. Once the Navy and the contractors knew the first aircraft would get off the ground, the contractors would address other capabilities of the plane in subsequent prototypes. For example, the second prototype would test the propulsion system. Other FSED aircraft would examine the A-12's avionics and carrier suitability. *See, e.g., McDonnell Douglas Corp. v. United States,* 35 Fed. Cl. 358, 362 (1996). ("Each FSED aircraft would test different characteristics of the A-12; stealth capabilities would be verified in the 'fully capable, fully equipped' eighth aircraft that would serve as the basis for the production lots.").

The companies monitored the A-12's manufacturing schedule carefully. Mr. A.L. Briggs was the Vice President of McDonnell Douglas for Manufacturing Operations. His December 12, 1990 report assessed the A-12's manufacturing performance, the study of which he began in March 1990.

Briggs' March investigation "revealed serious differences between the program status reports and the actual conditions on the shop floor and in the tooling and detail parts fabrication." While status reports were showing first flight in December 1990, his assessment was that first flight would be at least "four to six months later" than stated. He reassessed the program again in June and found "no improvement." In fact, he believed "the program had worsened somewhat." Such assessments were grim, but McDonnell Douglas received more favorable commentary:

> The Technology exists and McAir Manufacturing has the ability to build the A-12 aircraft as designed. Fabrication, Assembly and Tooling are all geared up and focused on the job at hand. By creating a realistic schedule and managing to that schedule, McAir Manufacturing can deliver the major assemblies to Tulsa in accordance with the revised plan.

The report on General Dynamics was ominous. Mr. Briggs said, "GD engineers designed an airplane that GD Manufacturing could not build." He explained, "[t]he complexity of the composite parts was far beyond manufacturing's available technology in tooling and part fabrication." If Admiral Morris had been aware of this evaluation, it would have given him reason to be concerned about timely completion.[13] By December, however, Briggs had concluded that the "[m]anufacturing team is capable of building the A-12 aircraft as it is now defined. . . . The revised schedule for getting the major assemblies to Tulsa and the activity at Tulsa are energetic, but achievable."

Mr. Briggs compiled a year-end appraisal of the A-12 schedule position in December 1990, discussing

[13] It may not matter whether Admiral Morris knew about such reports. The Federal Circuit ruled that so long as the information was available to the Government, the court may consider it in reviewing the contracting officer's decision. *See, e.g., Empire Energy Mgmt. Sys., Inc. v. Roche*, 362 F.3d 1343, 1357 (Fed. Cir. 2004).

the progress of "McAir, GDFW, and Tulsa" in meeting the contract's revised schedule.[14] He concluded that the "Tulsa effort . . . [wa]s progressing on plan." In St. Louis, the forward fuselage was "[p]rogressing satisfactorily," as was the aft fuselage, despite delays resulting from the Navy's rejection of certain parts. Work on the R/H Outer Wing "suffered severe set backs due to recently identified engineering changes" but the delivery date for the parts was "still achievable."

The report also discussed General Dynamics' offload issues. The "[t]ooling and parts fabrication are progressing [but] [a]pproximately 20 critical parts are being tracked by the Navy as potential show stoppers." The center fuselage was "[p]rogressing satisfactorily" to meet delivery dates, and the L/H Outer Wing was experiencing the same problems as the right outer wing. The Inner Wing assembly, however, was "in worse condition" than when the delivery schedule was established. The report indicated that there was "[n]o known resolution at th[e] time."

The delivery date was August 1991. Briggs felt the date was still achievable, but he was "losing confidence." He detected a "serious deterioration of the wing condition in the last few days." Under

[14] McAir, General Dynamics Fort Worth (or GDFW), and Tulsa are references to the contractors' manufacturing centers. McAir was a division of McDonnell Douglas located in St. Louis, Missouri.

existing conditions, General Dynamics "probably will not be able to build the Inner Wing assemblies on or near schedule." He identified possible solutions for the situation, including integration of a joint assembly team.

Mr. Briggs concluded the report as follows:

> I believe the March 1992 First Flight date is still achievable, but only after significant changes which I intend to pursue immediately after the reorganization.[15] My confidence in the March 1992 flight date is reduced to approximately 50% based on current conditions.

Mr. Dave Cormany of General Dynamics highlighted manufacturing problems in an interoffice memorandum sent December 14, 1990. He expressed this dissatisfaction:

> In walking through and actually touching the two surviving [aircraft] parts this morning, I am convinced that if either makes it, it will not be near term. Therefore, we must assume that, as of today, we have NO coverage for ships 1-3 for this part.
>
> . . .
>
> I was very, very dissatisfied with the lack of control we had in inspection/support

[15] The phrase, "immediately after the reorganization" highlights the importance that both the Navy and the contractors placed on restructuring the contract.

areas I visited today. We either had people sitting around with no work in areas we are calling critical, or we had parts languishing in areas they had no business being, with no drive to work them or move them. Both are unsatisfactory.

I believe we can produce one piece of any rib part number each eight to nine days, if we really want to. If we want an A-12 program, we had best want to do so with all our hearts. SOUND "BATTLE STATIONS"! We are in desperate trouble.

Mr. Cormany sent a second memorandum on December 28, 1990:

Perhaps there is some misunderstanding regarding the urgency on the subject LH rib for SWBS 3810. This rib started layup approximately 19 December. It is still not complete. Since 26 December, I have personally visited the part of each shift day during the holiday and have been told daily there are no problems and that the part should go to cure "next shift." It still sits exactly as it did on that date.

Folks, we have NO PARTS for any aircraft of this part number. We are in a program day-for day side until the part reaches stock. We are currently breaching the drop-dead commitment date for the program of 31 March 1992, due to this part. I just do not understand how we can let the program critical parts sit for days and days. I am now very concerned with total out time

> accumulation for the part, in light of its extended layup period, and the upcoming week-end and holiday.

PLEASE get someone working on this job, and get it done! . . .

Plaintiffs' own technicians were not happy with the manufacturing process. The Navy seemed at least acquiescent prior to Pentagon intervention in December 1990, if concerned about the pace.

3. Testing

Ground testing was underway in December; flight testing would have begun with first flight. The Government terminated the A-12 contract for default nearly a year before first flight. Admiral Lockard described his frustration in November 1990:

> [No one could] predict with accuracy when we were going to fly the plane until we had, in fact, successfully built the parts for the first one. Because we were having difficulty building those parts, I could not come to a determination of when we would actually – with some level of certainty – fly the first airplane.

Admiral Lockard had expressed this concern at a Design Review Briefing in November 1990. He added, "[b]usiness factors still cloud [the] technical picture."

4. Business Issues

Work on the A-12 contract progressed over budget during the early stages of contract performance. Ms. Eleanor Spector, Deputy Assistant Secretary of Defense for Procurement, testified that "the contractor was spending at a rate of 120 million to 150 million per month." Admiral Morris stated that the contractors' "rate of investment on a monthly basis" was around $150 million.

Ms. Spector[16] explained how financial problems could affect contract performance:

> [W]hat generally happens when a contractor has financial problems is it's unable to do work-arounds. It's unable to do new technical approaches that may be necessary to solve a problem. That's particularly true in these fixed price development contracts where the whole contract is for development, and you have to keep trying different things if the first thing doesn't work. So when you're having financial difficulties, it becomes difficult to do new design approaches, necessary fixes to problems that inevitably arise.

[16] Eleanor Spector's testimony was valuable. Documents produced in discovery showed that she had insight approaching prescience. For example, she opposed putting the A-12 out for bids on a fixed-price contract. She relented only with assurance that the Government would share its stealth technology with the contractors. Otherwise, she predicted, it cannot be done.

Plaintiffs asserted that performing to the specifications on a fixed-price contract was impossible.[17] They wanted to modify the contract terms due to impossibility of performance and nondisclosure of superior knowledge regarding stealth technology. Secretary of the Navy Lawrence Garrett asked plaintiffs' CEOs in a June 20 letter to provide detailed descriptions of the contractors' proposed options for proceeding with the A-12 Program. The contractors stated that the fundamental problem with the contract was its fixed-price structure. They proposed modifications but could not reach an agreement with the Navy.

Plaintiffs warned the Navy in September 1990 that insufficient funds were obligated to the FSED portion of the contract. They asked that funding be provided at a more rapid rate "to preclude the possibility that the contractors may have to stop work under the contract." The Navy refused this request on October 3, and a similar request by the contractors in November, but obligated a scheduled $ 185 million installment to the contract on November 1, 1990.

[17] Donald J. Yockey, Acting Under Secretary of Defense (Acquisition), apparently agreed. Prior to termination, he lamented, "[w]hy did we ever go out on a fixed price contract? We should have learned long ago that you can't develop complex systems to a fixed price."

C. SCHEDULE

Schedule problems have been an issue of paramount importance in the history of this case. They caused the Government to waive the requirement for first flight in June 1990, creating a *DeVito* waiver issue that is crucial to plaintiffs' case. *See DeVito v. United States*, 413 F.2d 1147, 188 Ct. Cl. 979 (Ct. Cl. 1969). Schedule problems caused the Navy to issue P00046, which overlapped the original contract schedule for Lot I and created a "nonsensical" situation. The P00046 schedule serves as the court's standard for measuring plaintiffs' performance.

The Federal Circuit ruled that the trial court should determine whether plaintiffs were in default at termination. We focused on schedule because other reasons that Admiral Morris gave for terminating the contract were not valid. *See McDonnell Douglas*, 323 F.3d at 1011; *McDonnell Douglas Corp. v. United States*, 50 Fed. Cl. 311, 319-24 (2001). Schedule again appears to be a key to resolving this case. The issue is whether the Government's termination for default is justifiable. Schedule is one basis for deciding reasonableness of the Government default decision. To know whether the termination was reasonable, we must know the amount of time remaining on the contract, according to the Federal Circuit. *McDonnell Douglas*, 323 F.3d at 1017.

1. First Flight

The A-12 contract included four options that permitted the Navy to order production aircraft delivered through 1995. The Lot I option was executed by the Navy on May 30, 1990, requiring plaintiffs to manufacture six A-12 production aircraft in addition to the FSED prototypes. This meant the contractors would deliver fourteen aircraft on dates certain through May 1992. The contract contained the following schedule for delivery of prototype and optional production aircraft:

	Aircraft Number	Delivery Date
	1	June 1990
	2	July 1990
	3	August 1990
	4	September 1990
FSED	5	October 1990
	6	November 1990
	7	December 1990
	8	January 1991
	9	June 1991
	10	August 1991
	11	October 1991
LOT I	12	December 1991
	13	March 1992
	14	May 1992

The contractors did not achieve first flight in June 1990. The Navy took no steps to terminate the contract.[18] However, the contracting officer at the time sent a letter to the contractors in July stating that they had not delivered the first aircraft in June as required by the contract and warned of the consequences of failure.[19] Negotiations for rescheduling the contract ensued.

[18] The Navy knew in Spring 1990 that the contract schedule would have to be restructured. Plaintiffs asked Captain Elberfeld, the Navy's A-12 Program Manager at the time, "[w]hen the first flight date was missed, what did you do about it?" He responded, "we all knew very well for many months before that it was not going to be achieved. I don't recall taking any specific action immediately after it passed."

[19] Contracting Officer Mutty sent a letter to the Team on July 12. He expressed "serious concern regarding [their] performance under the A-12 contract." They had "failed to deliver the first aircraft as required by the contract . . . [and that] failure could jeopardize performance of the entire FSED effort." He continued,

> [n]either your letter nor afterward have you provided any basis on which I could conclude that any of your obligations under the contract should be excused. The little information you have provided is far from adequate to permit an assessment of the state of your performance under the contract.

Mutty directed the contractors to inform the Navy when they would deliver first flight, their plan to meet the remaining FSED schedule, and their consideration for proposed contract modifications. He concluded with the following remarks: "[T]he Navy believes the contract is valid and enforceable on its terms. The Navy is not waiving any of its rights under the contract by affording you the opportunity to respond with detailed information."

The contractors' CEOs were John McDonnell and Stanley Pace. They presented a review of the A-12 Program to Navy officials on June 13, 1990. The major discussion points were Technical Issues, Schedule, and Cost Status. The report stated that weight of the aircraft was the top concern, but appeared to be "under control." The CEOs reported "No Major 'Showstoppers'" on technical issues. Schedule was next.

Management predicted first flight in the July 1992 through September 1992 period. The remainder of the FSED schedule would be twelve to fourteen months beyond the original plan. Cost estimates at completion were "still in work, [with] a large variance between estimates," according to the CEOs. They acknowledged that significant challenges remained, but announced that the Program was under control. They discussed conclusions and recommendations at the high-level meeting, using slides with the following captions:

CONCLUSIONS

- System Performance is Good With Excellent Overall Operational Capability

- The Predicted Cost of the FSED Program Will Exceed the Ceiling by a Magnitude That the Companies Cannot Absorb

- The Production Lot Option Not to Exceed Prices Are Also Predicted to Exceed Those Specified in the Contract

- Current Schedule Does Not Match Contract Schedule

- Production Lot III Would Be Exercised Prior to Sufficient Testing to Demonstrate System Performance

- The Concurrence of the Program Will Likely Lead to Milestone IIIB Not Being Met

RECOMMENDATIONS

- The Program Teams, Government and Industry, Have Been Studying Various Approaches to a Restructured Program

- We Should Be Authorized to Complete this Study and Propose a Program and Business Arrangement That Is in the Best Interest of the A-12 Program, including:

  - Deliveries Per Rephased Schedule for FSED and Lots 1, 2, 3 & 4

  - Adjusted Specification

  - Navy Added Requirements

  - Contractor Claims

2. P00046

Mr. Lamers of General Dynamics was the principal program manager for the contractors. He predicted they could deliver first flight in July 1991. The Government undertook an assessment of whether

this goal was obtainable. *See McDonnell Douglas,* 50 Fed. Cl. at 317 (noting "[t]he Navy wanted a reasonable schedule, not an unachievable one. The contractors and the Navy convened a strategy board to put together a realistic schedule for first flight."). The contractors were working to an aggressive schedule, but they would not sign up for one. They did not want to become contractually bound to a new schedule because of the uncertainties of controlling weight without having the benefit of shared technical information from the Air Force. Captain Elberfeld developed a plan to restructure the A-12 contract through the Defense Acquisition Board. He testified that the DAB would serve to

> get the program officially rebaselined. It would be the formal approval step necessary to get the program back into something that was manageable and controllable, in the sense of having the program documentation, the contract schedules, the financial and business arrangements and so on, all in place so that cost, schedule, and technical aspects of the program could be managed more efficiently, instead of working to a contract that had milestones that had already been missed . . .

Elberfeld's plan included a "path to the A-12 DAB." He issued P00046 as a step along this path – a modified unilateral FSED delivery schedule for

aircrafts one through eight.[20] According to Captain Elberfeld's plan, the parties would resolve the technical issues at CDR and the Navy would present the revised technical baseline to the DAB for a decision.

The Navy issued P00046 on August 17, 1990. The modification moved the due dates for the FSED prototypes back about eighteen months; the revised schedule called for first flight in December 1991. The modification spread the remaining prototypes out as well, doubling the time for delivery between each aircraft. Instead of one per month, P00046 required delivery of one prototype approximately every two months. Aircrafts two through eight were due February, June, August, September, November, and December 1992, and February 1993.

P00046 revised FSED aircraft delivery dates but left Lot I and later milestones intact. Captain Elberfeld testified that after he issued the contract schedule modification, the Navy had "no schedule for the Lot I aircraft that you would call a realistic schedule." This fact was generally accepted among

[20] Captain Elberfeld testified that he was the person responsible for issuing P00046 to replace the bilateral schedule in the original contract. He approached his duty in a methodical and conscientious manner, and his schedule was reasonable. *McDonnell Douglas*, 50 Fed. Cl. at 316-19. The Navy did not waive the new schedule by announcing other acceptable dates for first flight. *Id.* at 319. The Federal Circuit affirmed these 2001 conclusions. *McDonnell Douglas*, 323 F.3d at 1018-20.

Navy officials familiar with the Program. The contractors could not have delivered Lot I aircraft on the dates the parties originally intended because of an overlap.[21]

[21] The following chart shows that the schedule in place required plaintiffs to show that the first prototypes could fly before or at the same time they were to deliver fully-compliant production aircraft to the Navy:

Aircraft Number ORIGINAL FSED	Delivery Date	Aircraft Number P00046	Delivery Date
1	June 1990		
2	July 1990		
3	August 1990		
4	September 1990		
5	October 1990		
6	November 1990		
7	December 1990		
8	January 1991		
LOT I			
9	June 1991		
10	August 1991		
11	October 1991		
12	December 1991	1	December 1991
13	March 1992	2	February 1992
14	May 1992	3	June 1992
		4	August 1992

(Continued on following page)

Captain Elberfeld testified that the purpose of the unilateral modification was to serve as "a first step in achieving [the] overall delivery schedule. . . ." The lack of new delivery schedules for Lot I "was not meant to imply that there was any intent or any thought that those aircraft could . . . be delivered earlier than the FSED aircraft."[22]

The ultimate contract completion date sought by the remand order would be a moving target, if it exists at all. *See McDonnell Douglas,* 323 F.3d at 1017 (stating the Government must put forth "'*direct* evidence on the time which it estimated it would take [the contractor] to complete the contract'") (quoting *Lisbon,* 828 F.2d at 766). In fact, if contract completion as envisioned by the Circuit should be a definite date by which plaintiffs were to complete entire contract performance, this contract did not provide such a

5	September 1992
6	November 1992
7	December 1992
8	February 1993

[22] Additional testimony from this witness confirms that it was "no one's idea to [deliver aircraft nine before aircraft one]." We had the impression during trial that the overlap was a clerical error or oversight. This enabled the ruling that the unilateral schedule was reasonable and therefore enforceable. *See McDonnell Douglas,* 50 Fed. Cl. at 318-19. It appears likely that the parties did not consider Lot I then; it was an oversight. They assumed the contract would be restructured before Lot I became an issue.

date. Captain Elberfeld explained the expectations of performance with a research and development contract:

> The schedule for – completing contracts is something that takes sometimes years. Some contracts . . . [take] ten, fifteen years before they're closed out, even after the last aircraft is delivered. . . . I don't know what the schedule is to close out the contract. We had a schedule for delivering aircraft, we had a schedule for other milestones, like critical design review, preliminary design review, other major program milestones. But I don't recall the contract saying . . . [it] will be completed and closed out on this date, as one of the requirements of the contract.

Captain Elberfeld's recollection was correct; the contract did not provide a close-out or completion date. Later he observed, with a research and development contract, "[u]ntil you get to the end, you don't know what the last step is."[23]

During the months leading to termination, the contractors' internal schedules were showing that

[23] Captain Elberfeld was asked what level of contractor performance signified completion of the contract; i.e., what was the final act. Captain Elberfeld responded, "[i]t depended on what they were doing and what they were having problems accomplishing. . . . Until you get to the end, you don't know what the last step is." Captain Elberfeld testified that he had "certainly not" established a schedule for contract completion with modification P00046.

first flight would not occur in December 1991. Their projections showed first flight delivery three months later, in March 1992. Navy officials testified that defendant could not predict when the contractors would deliver first flight.

D. EVENTS LEADING TO TERMINATION

The Pentagon took over management of the A-12 Program in December 1990. Decisions regarding when and how to issue the notice to cure and other notices required by FAR originated from OSD. This development, along with the Government's need to obligate over one-half billion dollars to the A-12 program in January, marked the beginning of the end for the aircraft and for the contractors and their employees.

1. Department of Defense

The Department of Defense initiated a Major Aircraft Review during 1990 to investigate pending weapons systems. Its purpose was to determine whether proposed new aircraft were needed in the post-Cold War environment. The A-12 Avenger fell under that review.

The Secretary of Defense visited the McDonnell Douglas plant in March 1990, as part of the government evaluation of national defense needs in response to changing world situations and reduced national security threats. He learned of concerns

about the Program, but remained confident the Navy and the contractors could deliver the aircraft. He expressed confidence in the A-12 Program, and he assured Congress that the Navy's need for the aircraft persisted. The Navy would continue pursuit of its development.

The Defense Secretary reported results of the Major Aircraft Review to Congress in April 1990.[24] His comments about the A-12 Program were reassuring. Secretary Cheney told the Committee that the A-12 was "one of our most urgent requirements." He testified about the Navy's need for the Program and its smooth course of development.

Weeks after testifying to Congress, the Secretary became aware of problems containing costs in the Program and maintaining the schedule. He was troubled because his report only weeks earlier had not reflected these concerns. He had testified in glowing terms about the aircraft and the contributions that it would make to the Fleet. The Defense Secretary was embarrassed and annoyed that he had

[24] The Secretary of Defense discussed the Major Aircraft Review before the House Armed Services Committee on April 26, 1990. He faced mounting concerns about the federal budget deficit, however, and congressional demands for military budget reductions. He recommended continued funding for the A-12, but at reduced levels. The planned purchase of 858 aircraft with a maximum production rate of forty-eight per year would be reduced to 620 aircraft with a maximum production rate of thirty-six per year. This had a significant impact on the per-unit cost of the planes.

to return with a different assessment for the Committee so soon. He had to report that the Program was seriously behind schedule and the projected cost of completion exceeded earlier estimates. The Secretary met with the contractors during the Summer of 1990 to address his concerns. He reiterated to the contractors his belief that the A-12 was a high-priority Navy program, however.

Two reports published in November 1990 had an impact on the A-12 Program. Both were critical of the Pentagon's part in the Major Aircraft Review. The Beach Report criticized the Navy's finding that the contract could be completed within its ceiling price, concluding that the program manager should have anticipated the extent of schedule risk. It criticized other Navy officials close to the Program as well. The other report, from the Department of Defense Inspector General, found that the Major Aircraft Review had not been conducted properly and otherwise was handled poorly.[25]

[25] The Secretary of Defense stated during his pre-trial deposition, "[t]he [Inspector General] has generally done good work for the Department of Defense. I don't always agree with them, but sometimes they produce good results. In this particular case, they recommended termination for default, which is what I ultimately did."

DOD counsel advised that the quoted excerpt from the deposition should read, "[i]n this particular case, *we* recommended termination for default which is what *we* ultimately did." (emphasis added). Government counsel presented the Secretary an errata sheet before trial. The Defense Secretary

(Continued on following page)

The Secretary of Defense signaled in December 1990 that he no longer supported continuation of the A-12 Program. He wrote a classified memorandum to the President expressing his disappointment in the A-12 Program, the Navy's handling of production, and the Major Aircraft Review. He stated that he would take corrective action promptly. The Under Secretary of Defense for Acquisition resigned.

Citing "serious shortcomings" in the A-12 Program, the Secretary directed his Deputy to evaluate the A-12 and report back in ten days. OSD instructed the Navy to "show cause" by January 4, 1991, why the Defense Department should not cancel the Program. The show cause letter stated:

> The A-12 Program is in serious trouble. The apparent schedule slippage, cost growth, and management deficiencies in this Program are intolerable. If we cannot spend the taxpayers' money wisely, we will not spend it. Accordingly, I direct you to show cause by January 4, 1991 why the Department should not terminate the A-12 Program and pursue other alternatives.

agreed that counsel's suggestions of error reflected more accurately what he believed occurred. If so, the decision presented by Admiral Morris on January 7, 1991 may have been removed yet another level, to the Inspector General's office. The Inspector General did not testify; his or her name did not arise during trial. The errata sheet was provided to plaintiffs' counsel and the court the morning of the Defense Secretary's trial testimony.

Admiral Morris was the contracting officer then, but the Office of the Secretary of Defense had taken over management of the A-12 contract and the A-12 Program. OSD instructed the contracting officer to issue a notice to cure on December 17. Admiral Morris notified McDonnell Douglas and General Dynamics that the contractors' performance was "unsatisfactory." The cure notice to the contractors included the following warning:

> [T]he Government considers your performance . . . unsatisfactory. Specifically, you have failed to fabricate parts sufficient to permit final assembly in time to meet the schedule for delivery of FSED aircraft. In addition, you will not deliver the Lot I pilot production aircraft in accordance with the contract schedule. Moreover, your failure to meet specification requirements, such as aircraft weight,[26] jeopardizes the carrier suitability of your design.

The contracting officer stated that such conditions were "endangering performance of [the] contract" and unless the problems were "cured by 2 January 1991 the Government may terminate for default" pursuant to FAR 52.249-9.

[26] OSD's legal department directed the contracting officer to include weight of the aircraft as one of plaintiffs' deficiencies. This was incorrect. *See McDonnell Douglas*, 50 Fed. Cl. at 323; *McDonnell Douglas*, 35 Fed. Cl. at 373-74.

Admiral Morris explained his purpose in issuing the notice:

> The purpose of the cure notice was to advise the contractors they were failing to make progress, and that the Navy was extremely concerned that it would . . . be able to get an aircraft that would satisfy its intended purpose in buying the aircraft. And so this was a means of asking the contractors to address the many issues that were being communicated to the contractors through various people through various means at the time, and to tell the Navy what it was going to do to address those issues.

The notice to cure was an item on the checklist of requirements the Government must follow before terminating a contract for default. For all practical purposes, the decision to terminate had been made, but the notice created a sense of urgency among the parties. The notice also set off a series of high-level meetings among the principals.

2. Meetings Before Termination

Plaintiffs met with government officials on December 18, the day after the Navy issued the cure notice. The Government was represented by Donald J. Yockey, Acting Under Secretary of Defense (Acquisition), Terrence O'Donnell, General Counsel, DOD, Dennis Trosch, Associate General Counsel, DOD, Eleanor Spector, Deputy Assistant Secretary of Defense (Procurement), Gerald Cann, Assistant

Secretary of the Navy (Research, Development & Acquisition), Craig King, General Counsel, Navy, and Rear Admiral William R. Morris, Assistant Commander for Contracts, NAVAIR, and contracting officer for the A-12.

The Contractors were represented by John McDonnell, CEO, McDonnell Douglas, and Jerry Johnston, President, McDonnell Douglas; and Bill Anders, CEO, General Dynamics, and Jim Mellor, President, General Dynamics. The purpose of the meeting was to discuss the contractors' response to the cure notice, and to decide whether perceived problems could be cured by January 2.

Mr. Anders conceded at the meeting that the aircraft was not on course. He said the A-12 would not fly in January 1991, and "[a]ll deficiencies cannot be corrected." He said plaintiffs would "do the best we can, [to] deliver a satisfactory aircraft for the Navy, [but] Mother Nature won't allow correction of all defects." He left it to the Navy to decide whether the contractors' best was "good enough." He added, however, "[i]t's going to be a good airplane, one I would like to fly."

Under Secretary Yockey wanted to know whether the contractors would complete the FSED contract regardless of the cost; that is, "for whatever it takes." Mr. McDonnell's response was, [the contract] "has got

to get reformed to a cost-type contract or we cannot do it. We need some form of Public Law 85-804."[27]

Admiral Morris took notes at the meetings that were held in response to the notice to cure. He offered interpretations of comments made at those meetings during his testimony:

> I think Mr. Yockey reaffirmed the fact that the Navy continued to have the [fixed-cost] requirement, and the question was, could the deficiencies be corrected so that essentially the Navy's requirement could be satisfied. Mr. Anders responded by saying we're not going to be able to address those deficiencies by 2 January. All of the deficiencies that had been pointed out cannot be corrected. Mother Nature, or laws of physics or what have you, will not allow all of those to be corrected, they'll do the best they can, and the Navy was going to have to decide whether that's good enough.

Plaintiffs asked Admiral Morris about oral communications he had with the contractors' representatives prior to January 2. He testified to "three or four specific meetings or telephone discussions with both [contractors]. . . . I believe they were using me as

[27] Pub. L. No. 85-804 authorizes the President of the United States to grant agencies the power to provide extraordinary relief in furtherance of national defense. 50 U.S.C. § 1431; *see McDonnell Douglas*, 50 Fed. Cl. at 314 n.2.

a sounding board for various ideas they had, in terms of the response to the cure notice. . . ."

Admiral Morris encouraged plaintiffs to address the problems of cost overruns, which he said was a "real issue," though he knew the contractors were bound to a fixed-price incentive contract. He added, "[t]he contractors had clearly articulated during these meetings that they would require extraordinary relief under 85-804, or – and/or, at times, a restructure of the contract, which I believe had to take place under the authority of Public Law 85-804."

The contracting officer discussed some of the technical issues:

> [T]here was much follow-through that had to take place on the part of the contractors to address the issues that had been identified there and, of course, there were many milestones ahead, including first flight and the OPEVAL and TECHEVAL, and all of the technical reviews that would assure that the Navy was getting its desired aircraft. . . .

Admiral Morris said the main issue with the schedule was, "when is all this going to take place? When are we going to get the aircraft that had been contracted for? . . . I was encouraging that realism be addressed and that we get everything on the table so that we can proceed and go forward. . . ." Asked about possible alternatives to 85-804 relief, Admiral Morris said this:

> It was very hard to put a boundary around each of the issues, if I may categorize them as cost, schedule and performance. I was certainly seeking an opportunity to try to address each of those issues if, in fact, they could be addressed within the contract itself, without going forward with extraordinary relief and without having to restructure that contract . . . which I did not have the authority to do and which would require 85-804 relief. . . .[28]

The contractors met with government officials many times in late December to discuss the A-12 contract. At one such meeting, Assistant Secretary of the Navy (Research, Development, and Acquisition) Gerald Cann stated that the "Navy needs the A-12." He added, however, "[b]oth companies have failed cost, schedule and performance." He urged the contractors to respond to the cure notice because the Navy "need[s] to get back to SECNAV by 2 Jan, show cause to SECDEF by 4 Jan." The Navy reported that it "want[s] to proceed with FSED and Lot I."

Secretary Yockey announced that the Secretary of Defense wanted a report on the program by January 4. Mr. Yockey said the Secretary was "disturbed by

[28] The contractors' financial condition is a factor of importance in reviewing issues that may have contributed to justifiable default termination. *See McDonnell Douglas*, 323 F.3d at 1017. Admiral Morris testified that he was "in no position to judge the seriousness of the financial situation of either firm at that particular time. . . ."

program problems." Mr. McDonnell stated that they "[m]ust work out of [the] problem together," but emphasized that the contractors were "not in default." He asked, "where [do] we go from here? Is there a way to go together?" Mr. Anders agreed, stating that "[b]oth contractors and Government signed [the] contract. It won't work if we don't solve [it] together."

Other important points from the minutes of this meeting relate to negotiations regarding restructure of the contract. Mr. Anders wondered why the Government could not address a general solution. "We jointly created a bad contract. [The] Government has a responsibility also to fix the contract." Mr. Anders noted that a "year ago[, the] Government estimated the contractors [were $] 1.0 billion above ceiling. . . . We have a mutually bad deal."

Mr. Cann informed plaintiffs that the Government's "response will depend on what contractor[s] propose." He told them to "propose what loss you will take. Government is not going to walk away from [a] valid contract. There is a way under the law to deal with it – [the] Navy has to convince OSD, who has to convince SECDEF, who has to convince the Congress."

Secretary Yockey raised the contractors' complaint that they were not receiving sufficient progress payments quickly enough, and the suggestion that conversion to a cost-type contract would reduce the problem. As transcribed from the notes, Mr. O'Donnell, General Counsel of DOD, remarked, "You estimate the EAC [Estimate at Completion] at 7.5B[illion

dollars] for progress payments. [That's] a 2.5B[illion dollar] overrun!"

Mr. Anders returned to the problem that Admiral Morris referred to as "physics." Morris' notes of Anders' comments state, "Mother Nature remains a real challenge – [we are] on the edge of state-of-art. Tough to nail down future costs."[29]

Notes of a Government-only meeting following the meeting with the contractors shows that government officials disagreed about how they should proceed. Secretary Cann wanted the "contractors to tell us what they can do. I don't want to provide [the] contractors our minimum requirements.[30] I want to hear what they have to say first."

Ms. Spector thought they should provide "minimal requirements" to the contractors. "If we don't give them any indication of what could be acceptable, they may be off the mark." Secretary Yockey agreed with Mr. Cann that they should not "provide any basic requirements" as a first response. "Lets hear from them first. Its important that they think the problem through and tell us what they can

[29] This was a key problem throughout, recognized by all parties: The Government should not have attempted this project with a fixed-price contract; neither, of course, should the contractors have agreed to attempt it.

[30] The officials are discussing a possible restructure of the contract here. The reference to "minimum requirements" refers to the Government's demand for consideration from plaintiffs.

or are willing to do." Ms. Spector persisted: "We need to list five or six basic things that need to be addressed. They may only cover some of them if we don't." Mr. O'Donnell observed that PL 85-804 relief would be "distasteful," and the contractors should know it. Under Secretary Yockey agreed, adding, "[t]hat, combined with risks, indicate [the] contractors really have to make progress quickly."

The parties met again on December 21. Meeting minutes reveal that the contractors' financial situation and the state of the A-12 Program were among the Government's concerns going forward. Mr. Anders of General Dynamics understood the situation precisely, it turns out. He offered the following remarks:

> I have reflected a lot on the last meeting. Rumors abound. You can hear any you want. I hear how important the program is, how much the Navy needs it. It's reassuring if that's the position we are in, but others say we are going through a "kubuki dance"[31] preparatory to a formal termination of the program. Is it really a *fait accompli* that the program is dead? Are there really two alternatives available?

[31] The reference to "kubuki" is not explained in the record. We understand the term to be Japanese, referring to traditional Japanese theater distinguished by elaborate makeup. It seems from the context that Mr. Anders was expressing concern that the Government might have been "stringing them along."

Secretary Cann assured Mr. Anders that the Program was not "dead" if the Navy and the contractors could somehow convince the Pentagon to continue. Secretary Yockey added, "[i]t's a question of whether the program in its current state can satisfy the requirement. The question is, can you correct deficiencies to provide an aircraft that meets the requirements?"

The contractors had to demonstrate for the Government that they could perform according to A-12 contract requirements, despite setbacks that had already taken place. Mr. Anders attempted to describe the contractors' difficult task with respect to this research and development effort, urging the Government to understand that "[t]his is the state of the art. We can't guarantee in detail what the aircraft will do. We don't know the unknown unknowns." He assured the officials that nonetheless, "[h]aving been burned badly on large composites, we think we are out of the woods. All we can do is bust our tails."

The conversation turned to the contractors' financial situation. Secretary Yockey noted that the Government would not "take unlimited responsibility." He advised the contractors to "respond to the show cause [and to] articulate what you would like to do. In doing so, make sure you're taking responsibility and some continuing responsibility. If we consider it has merit, we will entertain your proposition."

Cost remained a concern, as did the fixed-price contract. Mr. McDonnell responded to criticism of the

Secretary of Defense and others about plaintiffs' management issues as well. He said:

> The fixed price nature of the contract precluded good management. I did a study four years ago indicating we were heading down a slippery slope with fixed price contracts. We are not in the business of winning lawsuits. We would rather build airplanes. If we can work this out, we'll unleash everything on the Hill that we can to help.

Mr. McDonnell said the Navy should not terminate "because [it] think[s] Congress won't go along" with 85-804 relief.

Secretary Yockey reminded the contractors that the basis for the notice to cure was the contractors' not making progress. He felt the Government "ha[d] the right to terminate for default." He had a different worry about the prospect of negotiating with the contractors. That is, Mr. Yockey was concerned about whether the system would meet the Pentagon's needs in any event: "The worst problem is that if we were to propose a solution, we could end up with a product that didn't meet our requirement. I have concerns that the airplane will do all you need it to do."[32]

[32] This is one of the issues the contractors would have wanted to pursue, presumably, had Mr. Yockey been available to testify in court. We have not located a record of Plaintiffs' having queried Admiral Morris about this comment during trial.

The Government held another closed-door meeting immediately following the briefing with the contractors. Minutes of this meeting and others showed a disconnect between the Pentagon and the Navy. For example, the Navy felt that OSD personnel were impinging upon some of the Navy's areas of responsibility.

3. OSD v. Navy

The Navy and the Office of the Secretary of Defense were at odds regarding the A-12 Program in a number of respects, including the Pentagon's handling of the termination. At a closed-door meeting, Navy official Gerald Cann said he felt the contractors "kn[ew] what kind of solution they need to provide, [but] [t]hey are working serious cash flow issues. If we were to [terminate for default], we would cause major problems for them." Under Secretary Yockey's view was more practical, or perhaps pragmatic from the standpoint of OSD.

The meeting minutes describe the following exchange:

> Cann: "We need to give you a technical brief. We have gone through 1-½ years of critical design review[ ] (CDR). The deficiencies are being addressed. We have growth areas in the plane. Trade offs will be made in terms of capabilities as long as our needs are met. This always occurs in a development program."

Yockey: "I will want to get a certificate of technical adequacy from both Navy and contractors. We have to make sure the product is suitable for our needs."

Cann: On [January] 3rd, I want to get my technical group over here to brief you so that you know where were are coming from. The technical issues have come together. There's still some risk but it's coming together.

Yockey: "It bothers me that we go out with a specification that we say is our requirement [yet] we never get it complete, such as in this case the weight of the aircraft which affects other requirements."[33]

Cann: "We lay out a specification that we want and think is necessary. We don't always know that it can be achieved. That's why we have development – need to make trade-offs to achieve overall requirement."

Yockey: "Why did we ever go out on a fixed price contract? We should have learned long ago that you can't develop complex systems to a fixed price."

[33] The Navy was comfortable with the A-12's weight, which it accepted. The Navy waived contract specifications that required a lighter airplane. *See supra* note 26. The focus on weight was a major disconnect between OSD and the Navy, and a reason for the appearance that Pentagon officials terminated the contract without understanding facts well known to the Navy.

They agreed that no one wanted to suggest the Government encouraged the contractors. Mr. Cann remarked, "[e]ven though we don't know what they are going to do on [January 2], I don't want to be in a position of having encouraged them to do one thing or another. We need to hear from them." Secretary Yockey concurred: "I don't want to be in a position of encouraging them to do one thing or another. We need to hear from them and then put together a strategy of what we would recommend for [the Secretary of Defense]."

Government officials discussed business issues in depth. Secretary Yockey estimated that the A-12 contract's cost to completion would be between $8 and $12 billion. They considered whether the contractors could handle loss of this magnitude.[34] Mr. Yockey understood how desperate the contractors were for cash. He believed the contractors could not continue performing with such losses; he did not want the

[34] They could not handle such a loss. Mr. Lamers of General Dynamics made the following comments at a meeting of contractors:

> [W]hat are we going to do to resolve this impasse with the Navy? Right now, we have – the two chairmen of the two companies are in continual communication with Navy acquisition executive, who is Gerry Cann, and they are working with him to come up with an acceptable package or agreement that will recognize the fact that while the contracts are behind schedule, and therefore in a dollar overrun situation, the contractor cannot absorb all those – all that overrun, ...

losses to be shared equally between the contractors and the Government. He felt the Secretary of Defense "has to send strong message to industry."

4. Contractors Respond to Cure Notice

The contractors responded to the Navy's cure notice on January 2, denying they were in default of the A-12 contract. They asserted that the unilateral schedule was not enforceable and the contract specifications were not achievable. They added, "[w]hile the contractors will not meet the delivery schedule or certain specifications of the original contract, or the revised FSED delivery schedule . . . for the reasons set forth below, the contractors are not in default of the A-12 contract."

> As the Program has developed, it has become clear both to the Team and to the Navy that the schedules and certain of the specification requirements, such as weight, were impossible to satisfy.
>
> . . .
>
> The Contractors have been forthright with the Navy through this Program in surfacing problems as they have developed. We have worked with the Navy in good faith to overcome these problems and to deliver the best possible aircraft. The Navy cannot now ignore the fact that it has been informed of the difficulties, or that it has encouraged the Team to continue performance despite its knowledge that the delivery schedules and

> the literal terms of certain specification requirements were not achievable, nor can the Navy deny that the Team, in reliance on those encouragements, has diligently prosecuted the work at enormous expense to both companies.
>
> . . .
>
> [T]he Team has been fully committed to the success of the Program, and has diligently prosecuted the work relating to fabrication of parts and all other aspects of performance in a manner that reasonably assures a satisfactory completion of the FSED and production phases of the A-12 Program.

Much of this comports with the court's understanding of the case. The contractors certainly cooperated with the Navy and they worked closely with each other to "surface[ ] problems as they developed." A review of the record shows that overall, this was more a dispute between the Navy and OSD than one of Government versus Contractors. The contractors offered the following assurances:

> First, with respect to the design and manufacturing process, the Team has made significant progress in the past several months. Nearly all structural drawings have been released to manufacturing. Since July 1990, 2,030 tools have been completed. Manufacturing processes and yields are dramatically improved.
>
> . . .

Second, the Team has made major advances in the A-12 Test Program. Wind Tunnel tests are 92% complete, well ahead of need as measured against current schedules. . . . Survivability and vulnerability testing, not even required for first flight, is 77% complete, and all tests will be complete prior to first flight.

Third, . . . substantially all of the approximately 20,000 procured line items will be available to meet manufacturing need dates, and, as of November 30, 1990, 95% of Aircraft 1 procured requirements have already been purchased and delivered.

. . .

The [cure] notice . . . states that the Team's alleged "failure to meet specification requirements, such as aircraft weight, jeopardizes the carrier suitability of your design." The team's design for the A-12 was found to be technically sound during the exhaustive Critical Design Review. While there is a shortfall against some parameters of the original technical specification, we believe that the current design meets the operational objectives.

. . .

[D]espite the exceptionally difficult technical challenge presented by this revolutionary design, during the Design Review Board (DRB) process that was completed in October 1990, the Team convincingly

> demonstrated that the A-12 design is technically satisfactory. Over 400 significant technical issues were addressed and resolved during this DRB process.
>
> . . .
>
> [C]ontractor development and manufacturing activities have been substantially and excusably delayed and impacted by acts and omissions of the government. Very important information vital to the performance of the contract, available to the Government, was not provided. . . . For those same and other reasons, the schedule unilaterally imposed by the Navy is also not valid; and, furthermore, it is unreasonable inasmuch as it purports to schedule FSED aircraft deliveries after delivery of Lot I aircraft.

The contractors concluded:

> We provide this response to demonstrate our commitment to the Program, and specifically to address the concerns you have raised. Our greater objective is to conclude successfully an equitable restructure of the contract and clear the way for the design and delivery to the Navy of superior new attack aircraft. . . .

The contractors' response accompanied a separate "Proposal for Equitable Restructure of the A-12 Contract." They asked that the contract be converted to cost-reimbursement and agreed to absorb a $1.5 billion loss on the contract in return. They would

waive all claims for equitable adjustments of approximately $1.6 billion. Cash flow to the contractors would be made on the basis of flexible progress payments, and the parties would restructure the contract so that procurements subsequent to Lot I would be subject to separate, future stand-alone contracts.[35]

5. The Weekend

The Chief Engineer for the Navy reported at a meeting with Admiral Morris on Friday, January 4, that technical challenges on the A-12 were typical for this type of development contract, and that the contractors could resolve the remaining technical challenges. The Navy and the Joint Requirements Oversight Council had revalidated the operational requirements.[36] Despite this optimistic assessment of

[35] Secretary Yockey had no concern that the contractors were incompetent or otherwise unable to handle the A-12 contract; he was worried about the appearance of a "bailout" if he allowed plaintiffs to continue. He would have been willing to go forward if the contractors could have accepted a $2 billion loss and made other concessions. *See McDonnell Douglas*, 50 Fed. Cl. at 314 n.3 (concluding that Mr. Yockey, the major decision-maker on the scene at the time, was merely "haggling over price.").

[36] This optimistic assessment was the contracting officer's last official report on the status of the A-12 Program before Monday, January 7, when he terminated the contract for default. The Joint Requirement Oversight Council, or JROC, consisted of members from the Joint Chiefs of Staff. JROC conducted its own review of the A-12 requirements and concluded that the aircraft

(Continued on following page)

progress in resolving technical problems, OSD seemed determined to close down the Program.

The Secretary of Defense met with Navy Secretary Garrett, Under Secretary Yockey, and the Chairman of the Joint Chiefs of Staff on Saturday, January 5 and decided not to grant 85-804 relief. Secretary Cheney knew the A-12 Program would be cancelled as a result, but he testified that the Navy would decide whether to terminate the A-12 contract.[37]

Admiral Morris was not invited to the Defense Secretary's meetings with top military personnel on Friday and Saturday, and he did not know of the meetings' outcome. He was called in to meet with Secretary Yockey and other Department of Defense officials on Sunday, January 6. Secretary Yockey told Admiral Morris that Secretary Cheney would not provide 85-804 relief.[38] Yockey told Admiral Morris that he, "as the milestone decision authority, can no longer support the program because of cost, schedule, [and] performance problems, and I will not authorize

"satisfies all mission requirements." *McDonnell Douglas,* 35 Fed. Cl. at 363.

[37] This distinction resolved an apparent dilemma among counsel for defendant and for OSD regarding the role that the OSD was to have played; i.e., whether the Secretary was to have been removed from decision-making regarding termination, or involved, and to what extent.

[38] This is another circumstance about which plaintiffs surely would have wanted to question Mr. Yockey. We inferred that Admiral Morris received his instructions regarding default termination at this meeting.

the obligation of any additional funds for the program."[39]

That Sunday afternoon, Admiral Morris contacted NAVAIR's Navy's legal counsel, Margaret Olsen, to tell her he was prepared to terminate the A-12 contract. He terminated the contract for default the next day.[40] The

[39] Secretary Yockey, the person who carried the termination message to Admiral Morris, who played a major role in causing the contracting officer to terminate the contract he wanted to continue, and whose name appears on many pages of this Opinion, did not testify in any court proceedings. We found after the Count XVII trial that Mr. Yockey "recommended against both 85-804 relief and the continuation of the program because the contractors were not willing to accept a sufficient loss on the contract. . . . [and] that 85-804 would look like a bailout of the contractors." *McDonnell Douglas*, 35 Fed. Cl. at 365. The only route Yockey thought appropriate was termination. He wanted to terminate for default immediately, before more funds were obligated. *Id.*

[40] Following his meeting with Secretary Yockey, Admiral Morris contacted his supervisor, Admiral Gentz, and told him that the Defense Department would not authorize Public Law 85-804 relief, and that Secretary Yockey had withdrawn his support for the Program. This was Admiral Morris' last-ditch effort to save the Program. He hoped Admiral Gentz would encourage the "big guns" in the Fleet to try one last time to save the A-12. Despite this lack of high-level support, Admiral Morris wanted an opportunity to continue development. He laid out reasons for continuation without extraordinary relief. He did not think additional funding was the only way to sustain the Program, and he wanted to work with the contractors. On the day before termination for default, despite being denied "extraordinary relief," the contracting officer wanted to continue the contract. The same afternoon, however, he called a NAVAIR attorney to alert her concerning the likelihood of termination. The next day, he terminated plaintiffs for default.

contractors were due an installment of $553 million the same day, January 7, 1991.

The contracting officer's termination letter to the contractors stated:

> General Dynamics Corporation and McDonnell Douglas Corporation (hereafter Team) are in default of [the] Contract. . . . The Government, therefore, is terminating [the Contract] in accordance with FAR clause 52.249-8, "Default (Fixed-Price Supply and Service)" and 52.249-9, "Default (Fixed Price Research and Development)." . . .
>
> This action is based on the Team's inability to complete the design, development, fabrication, assembly and test of the A-12 aircraft within the contract schedule and the Team's inability to deliver an aircraft that meets contract requirements.

Neither Admiral Morris nor his counsel had the time to put together a termination letter for the contractors and a termination memorandum to justify the Government's action for the file. Some of the reasons for termination used in the memorandum resulted from directions of OSD's legal department. As a result, both documents cited reasons for default that previously the Navy had not considered reasonable bases for such action. The Navy had worked side-by-side with the contractors for many months preceding termination to resolve technical difficulties inherent in designing a plane that would

be stealthy, yet land on an aircraft carrier and meet other needs of the Navy.

Ms. Olsen prepared a termination memorandum in the early morning hours on the day of termination. She did not have much information about the A-12 contract at her disposal, so she used a termination letter from a previous Navy program as a template. She had not anticipated terminating the A-12 for default. Ms. Olsen used the P-7 for more than a baseline, however. She looked to language from the P-7 for substantive reasons for terminating the A-12, a major research and development procurement, for default. Thus, the contracting officer's termination memorandum for the A-12 reflects an analysis conducted for the P-7 program, not the merits plaintiffs' performance on the A-12. Language in the P-7 memorandum is identical to language of the A-12 document.[41] Ms. Olsen was questioned about the similarities when she testified:

> Q: Now, let's look at the further statement for "two or more years' delay in the completion of development," do you see that phrase?
>
> A: Yes.

[41] The P-7 memorandum stated, "Lockheed has made no case that two or more years' delay in the completion of development is other than Lockheed's fault. . . ." The A-12 Memorandum included the following: "[t]he Team has made no case that . . . two or more years' delay in the completion of development is other than the Team's fault."

Q: Do you know where you got that?

A: No, I don't recall.

Q: Now, Ms. Olsen, that's exactly the language that you put in the Lockheed [P-7] memorandum, isn't that right?

A: Yes.

Q: Is it also possible that you had not verified that two or more years was appropriate to the A-12?

A: And it's also possible that two or more years was the amount of delay projected in both programs.

Ms. Olsen had no idea what the basic issues involving the A-12 were, and did not have time to find out. Whether the contractors were two or more years behind is an important aspect of the case before us now.

Ms. Olsen was aware of correspondence between the contractors and the Navy, but had not seen the contractors' claims or their response to the cure notice. Her staff gathered information on the A-12 Program. She did not discuss the basis for termination with Admiral Morris. She did not seek information from the chief engineer, the program manager, or any technical personnel. She did not

discuss the termination letter with Admiral Morris, though he issued it to the contractors later that day.[42]

Admiral Morris' January 7 termination memorandum for the file was an in-house document that explained the rationale for termination:

> After considering the factors set forth in Federal Acquisition Regulation 49.402-3(f), I have determined to terminate this contract for the default of the Contractor.
>
> . . .
>
> The contract includes the [default] clause . . . , which can be found at FAR 52.249-9; and this clause, at paragraph (a)(1)(iii), provides that the contract may be terminated for default if the contract so fails to make progress as to endanger performance of the contract. As outlined below, the Contractor's performance evidences an inability or unwillingness[43] of this contractor to meet the requirements of the contract. The

[42] "Morris approved the termination memorandum at midday after less than an hour of review." *McDonnell Douglas*, 35 Fed. Cl. at 368. The A-12 termination memorandum did not reflect any contracting officer analysis of the time when the A-12 contractors were likely to complete the remaining contract effort. *See Id.* ("[Admiral Morris] did not review documents related to schedule or specifications.").

[43] No one else has suggested that the contractors were "unwilling" to build this aircraft. Admiral Morris certainly knew better. Presumably, Ms. Olsen copied that clause from the P-7 template.

team has made no case that three to nine months further delay in the delivery of the first aircraft or two or more years' delay in the completion of development is other than the team's fault, or that it is entitled to be relieved of the performance requirements of its contract.

Specifically, the team cannot deliver the first prototype aircraft required . . . in December 1991. Since June 1990, the team has consistently reported its delays; and the Navy's independent review confirmed that, given the state of the team's development efforts, delivery of aircraft and completion of related contract requirements could occur no sooner than . [sic][44]

The importance of this delay cannot be overstated. The production options must be exercised by dates certain to be enforceable. As a consequence of the team's delay, the Navy would be required to purchase production aircraft before verifying that the aircraft are operationally suitable and effective[45]. . . . Moreover, the delay so increases

[44] Despite his assertion that "[t]he importance of this delay cannot be overstated," the contracting officer did not know what the delay was. Yet the contractors and the Navy had discussed estimates for first flight. The Navy had told Secretary Cheney that the first flight date was expected in September 1992. Navy witnesses agreed that the September 1992 date was realistic and acceptable.

[45] The A-12 contract required that the Navy exercise all options to purchase production lots "before verifying that the

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the cost to the team of completing the contract that it casts doubt on their willingness to perform.

Specifically, the team cannot meet the performance requirements of the contract. The team is currently designing the aircraft to have a weight empty 7930 pounds in excess of the guaranteed contract weight empty. This additional weight precludes the team from meeting contract requirements for takeoff distance, cruise specific range, maximum airspeed, and fuel flow, all of which directly affect mission capability.[46]

Excuses offered by the team are as follows. First, the team contends that its development and manufacturing activities have been substantially affected by acts and omissions of the Government. Specifically, the team alleges that the Government failed to provide "very important information vital

aircraft are operationally suitable and effective." This justification therefore either was taken from the P-7 or invented by someone. A witness for the Government, Eleanor Spector, testified that this element of the contract schedule was a "risk" known before the contract award, and not "a consequence of the team's delay."

[46] Weight was not a problem for the Navy at termination. The design review process described earlier insured that the plane could take off and land on a carrier and otherwise would meet the Navy's stringent requirements for such a system. Using weight as a reason for termination was not Admiral Morris' idea, nor Ms. Olsen's, but that of the Office of Secretary of Defense.

> to the performance of the contract" that was available to the Government. Second, the team alleges that necessary risk reduction prior to the award of a fixed price development contract was not present in this effort. Intertwined is the argument that meeting the required weight called for by the specification is impossible.
>
> Third, the team argues that its obligation to perform is limited to amount of funds available, provided through incremental Government funding. Finally the team argues that the schedule is not valid and is unreasonable because it purports to Schedule FSED aircraft deliveries after delivery of Lot I aircraft.

The termination memorandum continued by addressing the contractors' assertions in response to the cure notice.

> The Government has provided the team all information relevant to the performance of this contract that the Government was required contractually to provide. . . .
>
> The weight guaranty in the contract specification was provided by the team. The team is currently projecting weight at 7930 pounds over the required weight which critically calls into question the aircraft's suitability for carrier operations. The added weight impairs the Aircraft's single engine rate of climb and increases substantially wind over deck requirements; both serious

considerations for carrier operations. The team has provided no valid excuse for not meeting the contract weight that it submitted and agreed to meet.

This contract is a fixed price contract that requires delivery of conforming goods by a date certain conditioned on the Government allotting funds in the amounts and at the times stated. It is not a cost type of contract where the contract is only required to work to the limit of available funds.

Finally, the overlapping schedule of FSD and Lot I deliveries does not relieve the team of the requirement to meet either Schedule. The FSD schedule was extended after the team failed to meet the original Schedule in the contract. The Lot I schedule could not be extended at the same time because too much uncertainty surrounded the team's ability or willingness to perform to any Schedule.

In summary, the team's failure to make progress and to deliver an aircraft meeting required weight has placed the entire program in jeopardy; and the contractors have offered no adequate excuse for these failures.

Mr. Cann's January 8, 1991 handwritten notes include this retrospective judgement: "Uncertainty was what did it in. . . ." Perhaps, but the decision to terminate the A-12 contract was driven by the $553 million progress payment that the Navy was to obligate on the same day. The Government's largest procurement ended in a weekend effort by Department

of Defense officials to avoid the Government's own default by failing to release half-billion dollars to plaintiffs on Monday, January 7, 1991.

E. LITIGATION HISTORY

The United States terminated its contract with McDonnell Douglas and General Dynamics, citing the contractors' inability to meet contract requirements and failure to make progress.[47] Plaintiffs sued to convert the termination for default to termination for convenience of the Government. Following trial, we ruled that the Navy's termination process was not a reasoned one and that the contracting officer had not been permitted to exercise the independence required

[47] The contracting officer issued a final decision pursuant to the Contract Disputes Act, stating as follows:

> On 17 December 1990, the Navy informed the Team that it considered conditions under the contract to endanger performance and asked the Team to cure those conditions. Having carefully considered the Team's 2 January 1991 response, I conclude that the Team has failed to explain or cure those conditions, and that the Team is in default of the contract for having failed to make progress and not meeting contract requirements. The A-12 aircraft will not be delivered within the contract schedule nor will it meet the weight guaranty contained within the contract specification.
>
> . . .
>
> This is the final decision of the Contracting Officer. . . .

of him by Federal Acquisition Regulations.[48] *McDonnell Douglas,* 35 Fed. Cl. at 368-73. Testimony and other evidence at the first trial showed that Admiral Morris terminated the contract mostly for reasons we thought unrelated to performance.

Defendant argued initially that government officials could have terminated the contract in Admiral Morris' stead, and had the authority to act on the contracting officer's behalf in any event. We stated, "[p]erhaps [other government officials] could have terminated the contract – we had no reason to address this issue. . . . [T]he Government offered no individual or entity other than the contracting officer as the decision-maker. In fact, defendant's witnesses disclaimed such a function during trial." *Id.* at 372. Defendant apparently abandoned that legal position later, and took pains to disclaim such activity by other government officials.[49]

[48] The contracting officer is a government employee with the responsibility of administering a contract for the contracting agency. Federal regulations require that he or she act as an independent arbiter to resolve disputes that arise with the contractor by "safeguarding the interests of the United States in its contractual relationships. . . . [while] . . . [e]nsur[ing] that contractors receive impartial, fair, and equitable treatment." FAR 1.602-2. We were impressed with the contracting officer in this case, a well-regarded, high-ranking naval officer who nevertheless was unable to administer the contract according to his best judgment.

[49] Defendant argued that the role OSD did play in the termination did not nullify the default termination, however. According to defendant, the termination for default was the

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The first opinion on this issue described the process leading up to termination in some detail to explain why it appeared that Admiral Morris did not make an independent decision to terminate the Program for default on the same day that he had been lobbying the Fleet for support to keep it going.[50] The ruling of the Court of Appeals for the Federal Circuit that Admiral Morris terminated the contract for performance-related reasons and exercised independent judgment apparently derived from Admiral Morris' testimony at trial. *McDonnell Douglas Corp. v. United States,* 182 F.3d 1319, 1327-28 (Fed. Cir. 1999).[51] The court found that it could be guided by Admiral Morris' testimony, stating:

" 'direct consequence of a legitimate exercise of OSD's statutory and regulatory oversight authority; [t]hat the discretion of the contracting officer regarding contract continuation may have been obviated by OSD's actions is of no consequence.' " *McDonnell Douglas,* 35 Fed. Cl. at 372. We had misgivings about that argument at the time, but rulings since then may have vindicated the Government's position. The matter did not arise again, however, because later the Government denied any influence or other actions on the Secretary's part.

[50] Admiral Morris was impressive as a conscientious witness and a flag officer of the United States Navy. Given the Federal Circuit's conclusions on remand, we must assume that once Admiral Morris understood the importance of the Government's right to terminate in the circumstances presented to him, he then conducted the necessary reviews and made a reasoned decision to terminate for default.

[51] The Navy and the Secretary of Defense disagreed in their assessments of the A-12 Program and their willingness to tolerate delay. The Navy wanted the A-12 for its Fleet and was

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> [The contractors] were in default because they acknowledged they would not be able to achieve the contract specifications and the contract requirements, . . . the[y] would not be able to meet the delivery schedule that was currently in the contract, [a]nd . . . they would not be able to perform the contract without extraordinary relief or additional funding for the contract. So they basically said they can't perform under the contract and they were in default of it.

Id. at 1327. He said he believed the contractors could not complete the project within the time allowed for performance. The Circuit noted Admiral Morris' testimony with approval:

> [A]s a result of the contractors' default, it would be nothing short of unconscionable for me to put the burden of the contractors' failure to make progress and the contractors'

prepared for compromise. The Secretary had other concerns and was more critical of the Program. According to the Circuit:

> The trial court's factual findings do in fact establish that the Navy did not want to terminate the A-12 Program. Instead, at all times up until the very end, the Navy hoped to preserve the Program and its A-12 aircraft. That is not to say, however, that Contractors were not in default under the contract, or that the Government did not have the right to terminate for default.

McDonnell Douglas, 182 F.3d at 1327. The appeals court concluded that the Navy's reluctance to terminate the contract was indicative of the serious nature of the contractors' default. *Id.*

> failure to fabricate parts, so as to endanger performance of the contract, put that burden on the Government and the taxpayer to reimburse all costs and to pay the contractors a profit for their failures.

Id. at 1328. The appeals court made the following conclusion from Admiral Morris' testimony:

> [Admiral Morris] thought that he had three choices: to terminate for convenience, to terminate for default, or to do nothing. He rejected the latter as 'irresponsible,' thus focusing his attention on the other two choices. He eliminated the termination for convenience first, because he believed Contractors to be in material breach of the contract.

Id. at 1327. Thus, Admiral Morris terminated the contractors because he believed that they were in default of the A-12 contract, and it would have been unconscionable and irresponsible for him to terminate for convenience or do nothing.

The Circuit's remand order stated that the court so far had addressed only procedural matters and directed trial on whether the contractors were actually in default at termination. The burden of proving plaintiffs were in default was on the Government, which offered justifications for its termination of the A-12 contract during the six-week default trial that ensued. The parties did not try this case on the *Lisbon* test, but on the contractors' failure to meet the contract schedule. We had ruled earlier on the

Government's other reasons for terminating plaintiffs for default: weight of the aircraft, plaintiffs' financial status, and repudiation or abandonment. It appeared then that schedule was the only issue remaining.

The modified schedule called for first flight nearly a year after the Government terminated plaintiffs for default, but first flight was only an "interim deadline."[52] The contractors and the Navy had known that plaintiffs would not make first flight, so the issue for trial was whether the unilateral schedule known as P00046 was reasonable and enforceable. A unilateral schedule must be reasonable to be enforceable, so testimony centered on whether the Navy was reasonable in imposing a December 1991 first flight deadline.

Testimony showed that the schedule was reasonable, and we entered judgment for the Government. The Federal Circuit ruled on appeal, "finding that the unmet first flight date in December 1991 was reasonable is insufficient to sustain a default termination in this case." *McDonnell Douglas,* 323 F.3d at

[52] First flight was important and significant to those close to the A-12 contract. The significance arose from the parties' negotiations in the months leading to termination. The contractors' ability to conform to the first flight schedule had been a bellwether of sorts, and a concern of government officials. First flight was the first test. Missed milestones may be considered in conjunction with other factors in weighing the contracting officer's decision to terminate for failure to make progress.

1014.[53] The Circuit explained, "[i]n determining whether a default termination was justified, [trial] court[s] must review the evidence and circumstances surrounding the termination, and that assessment involves a consideration of factual and evidentiary issues." *Id.* The appeals court vacated the judgment and remanded for review of whether the default termination was justified according to the *Lisbon* standard. *Id.* at 1015.[54]

[53] We did not find that the due date for first flight was "unmet." If it had been, perhaps the issue would have been analyzed differently. This is important because the Government terminated plaintiffs almost a year prior to first flight. At termination, January 7, 1991, the parties understood that McDonnell Douglas and General Dynamics would not deliver first flight a year later, in December 1991. This is the reason the second trial focused on enforceability of the unilateral schedule. If the unilateral schedule had not been found reasonable, it would not have been enforceable.

[54] The Circuit did not express an opinion on whether we should reopen the record; the

> matter would be left to the sound discretion of the trial court. For that reason, we asked the parties repeatedly whether they recommended additional trial. Plaintiffs and defendant opposed reopening the record or taking additional testimony for any purpose. The parties agreed that the court has sufficient information in the trial record to rule on remand. Though the Federal Circuit expressed its inability to rule on "an incomplete record," the court was referring to the appellate record, according to defendant. Government counsel explained during a hearing last year:
>
> > [T]he Federal Circuit told us that the appellate record before it on the last appeal
>
> (Continued on following page)

This brief summary of developments in this case is limited to matters directly antecedent to this issues presented. These are the nature of the contract; the contractors' performance before termination, including the contract schedule; events leading to termination, including a number of earlier factual findings that are relevant to contracting officer's testimony and contemporary evidence; and the litigation that resulted from the Government's termination of plaintiffs for default. It does not address separate trials concerning matters raised by plaintiffs' complaint, or dispositive orders and other rulings on coordinate issues. The issue remaining is whether default termination was justified according to the *Lisbon* standard.

> was inadequate to answer [the question of whether the Government justifiably default terminated the contractors for failure to make progress], so it had no choice but to remand the case back to this Court. . . .

All of the answers to those questions were in this trial court record.

> Unfortunately, because of the way the arguments got briefed and the appendix assembled for the Court of Appeals, the answers to those questions and the necessary documents from this trial court's record were not included in the appellate record, so the Court remanded it.

Government counsel also expressed concern during a hearing last year that additional trial may be needed to address defendant's claim for a loss adjustment. That issue is moot now, given the judgment we enter today.

II. DISCUSSION

Default termination is a "drastic sanction . . . which should be imposed (or sustained) only for good grounds and on solid evidence." *J.D. Hedin Constr. Co. v. United States*, 408 F.2d 424, 187 Ct. Cl. 45, 431 (1969) (internal citation omitted). Termination is a forfeiture that is disfavored in the law and to be construed narrowly by the courts. *DeVito,* 413 F.2d at 1153. The Government must prove default: "If the [G]overnment can establish that [the] Contractors were in default, then the termination for default would be valid." *McDonnell Douglas,* 182 F.3d at 1329 (citing *Lisbon,* 828 F.2d at 765). This court reviews a contracting officer's decision to terminate for default *de novo.* 41 U.S.C. § 609(a)(3); *see also McDonnell Douglas,* 323 F.3d at 1018 n.3 (citing *Wilner v. United States,* 24 F.3d 1397, 1401 (Fed. Cir. 1994) (*en banc*)).

The Government's authority to terminate the A-12 contract for default derives from FAR 52.249-9, which the contract incorporated by reference. The default section for fixed-price research and development contracts states, "[t]he Government may, . . . by written Notice of Default to the Contractor, terminate this contract in whole or in part if the Contractor fails to – . . . [p]rosecute the work so as to endanger performance of this contract. . . ." 48 C.F.R. § 52.249-9.

Early cases ruled that timely completion must be impossible before the agency may terminate a contract for failure to make progress. *See* John Cibinic,

Jr. & Ralph C. Nash, Jr., *Administration of Government Contracts* 930 (3d ed. 1994) (noting that while the default clause uses the phrase "endanger performance," the Government was required to show that "it was impossible for the contractor to complete by the due date"). Current law does not require impossibility, or repudiation or abandonment by the contractors, but a showing by the Government of a demonstrated lack of diligence. *McDonnell Douglas,* 323 F.3d at 1015 ("[T]he default clause in this contract did not require a finding that completion within the contract's time limitations was impossible.") (citing *Discount Co. v. United States*, 554 F.2d 435, 441, 213 Ct. Cl. 567 (1977); *Universal Fiberglass Corp. v. United States*, 537 F.2d 393, 398, 210 Ct. Cl. 206 (1976)). Termination for default for failure to make progress usually occurs where the Government believes a contractor is so far behind schedule that completion of the job within the time remaining for performance is unlikely. *See Hannon Elec. Co. v. United States,* 31 Fed. Cl. 135, 143 (1994).

The Federal Circuit apparently found little agreement between plaintiffs and defendant on the standards this court should apply to a review of the contracting officer's decision to terminate. *See McDonnell Douglas,* 323 F.3d at 1014 (noting the parties "advance[d] drastically opposite interpretations" of the FAR default provision). The contractors argued the "absolute impossibility of performance" requirement of earlier cases, but the Circuit ruled "complete repudiation or abandonment" was no longer necessary.

Defendant asserted on appeal that this case presents issues of first impression: "[T]he circumstances of this case are so different that [the Court of Appeals for the Federal Circuit] should not seek guidance from precedent." *Id.* at 1015. The Government reasoned that "default termination was appropriate here given the Contractors' admitted inability to meet an interim contract milestone, the alleged impossibility for the aircraft design to meet contract specifications, and the Contractors' request for a restructuring of the agreement." *Id.*

The Federal Circuit resolved the matter with a "pragmatic approach" taken from the ruling in *Lisbon*. *Id.* According to the Circuit, *Lisbon* provides "the proper interpretation of the default provision [that] lies somewhere between the parties' extreme positions. . . ." *Id.* Its pragmatic approach also achieves a desired "balance between judicial aversion to default terminations . . . . and the fact that the Government, just as any other party, is entitled to receive that for which it contracted. . . ." *Id.* (internal citations and quotation marks omitted).

The Navy's default termination was justified if plaintiffs were in default of the A-12 contract on January 7, 1991. *See McDonnell Douglas,* 182 F.3d at 1329. According to *Lisbon,* plaintiffs were in default for failing to make progress on the A-12 contract at termination if the Government proves that at termination the contracting officer had a reasonable belief "that there was no reasonable likelihood that the contractor[s] could perform the entire contract

effort within the time remaining for contract performance." *McDonnell Douglas,* 323 F.3d at 1016 (quoting *Lisbon,* 828 F.2d at 765). The Federal Circuit discussed the importance of "decid[ing] the actual performance that the contract requires and the amount of time remaining for performance" before deciding whether there was no reasonable likelihood "the contractor[s] could perform the entire contract effort within the time remaining for contract performance." *McDonnell Douglas,* 323 F.3d at 1017.

The remand order describes three important tasks:

> (1) finding the "entire contract effort";
>
> (2) finding the "time remaining for contract performance" at termination;[55] and
>
> (3) deciding whether the contracting officer reasonably determined that the contractors could not be expected to perform the entire contract effort within the time remaining for performance.[56]

[55] The "time remaining for contract performance" calls for a "contract completion date." This phrase in particular creates much of the disagreement between plaintiffs and defendant.

[56] Answers to the first two questions are necessary predicates to the third; that is, whether the contracting officer acted reasonably in making his default decision. Nature of the contract and length remaining for performance are needed to conduct a *Lisbon* test.

A. THE PARTIES' ARGUMENTS

The contractors urge a broad interpretation of the Circuit's ruling in *Lisbon*. The appeals court used the term "entire contract effort" repeatedly and with emphasis. This must mean the court is to include eight FSED aircraft and six Lot I production aircraft in the fraction showing amount of work completed, plaintiffs contend. Their interest is in stretching the contract term out so they could clearly have met the timing requirements eventually. The longer their time remaining to complete the work, the more difficult it would be for the Government to prove contract performance was endangered.

Plaintiffs make their "entire contract" argument convincingly because the contract's "time remaining for performance" is unknown; the contractors say it is nonexistent. This is due to the nature of the A-12 contract – even beyond delivery of the Lot I production aircraft, the contract called for years of follow-on testing, aircraft maintenance, and contractor support on this major research and development effort. Plaintiffs' position is sensible. Research and development contracts typically lack clear indicia of contract completion. Their schedule guidelines are flexible, as befits the open-ended projects normally controlled by research and development contracts; often no end date applies. A witness for the Government testified, "[u]ntil you get to the end [of the contract], you don't know what the last step is."

Plaintiffs' other argument is that the contract completion date was waived – or disestablished – when the Government let original first flight pass in June 1990 and reset only part of the delivery schedule through the P00046 modification. P00046 included only revised delivery dates for the first eight aircraft and not the remaining contract milestones. In other words, plaintiffs maintain the Navy lost its right to terminate them for default for failure to make progress because it waived the schedule to contract completion.

The Government offers a flexible approach to review of the contracting officer's decision. Defendant contends that this court need decide only whether the weight of the evidence shows the contracting officer reasonably felt insecure about the contract's timely completion.[57] The contract contained a series of enforceable delivery dates, defendant points out; time

[57] We infer from defendant's various offerings during oral arguments and in briefs that the Government realizes that a date for contract completion was not spelled out in the A-12 contract. Dates of timely completion defendant has suggested range from first flight in December 1991, to TECHEVAL in April 1993, to CLIN 0058 in June 1996. CLIN 0058 was the final line item chronologically. Such suggestions are unconvincing for their shotgun effect, but defendant raised a plausible contention: Whether we use TECHEVAL as a mark of "essential completion," or the close of CLIN 58 as the final completion date, "performance remaining under the contract" can be tied to a particular CLIN or a specific date among the CLINs. This ruling is based on a series of dates that are tied to a particular CLIN, P00046.

was of the essence. The Government could terminate plaintiffs for default if the contracting officer reasonably believed timely completion was uncertain. Defendant argues that "entire contract effort" as used by the Circuit represents any convenient measure of the delivery dates. This measure may be used to evaluate the contractors' progress at termination.

Defendant's argument assumes an important fact: the yardstick we use to measure plaintiffs' progress is not so important as having one. That is, the "entire contract effort" need not include every segment of work contemplated by the contract, but may be any objective measure of the contractors' progress at termination.[58] Defendant's reluctance to point to a completion date was apparent during post-remand proceedings.

[58] This analysis is similar to the approach we took in the last opinion, however. A critical delivery date such as first flight might be considered a convenient yardstick against which to measure progress, as this was a key goal of all parties during early performance of the contract. Nevertheless, the Federal Circuit made clear that " 'the Government did not, as it urges, satisfy its burden by merely showing that the contractor[s] w[ere] behind schedule.' " *McDonnell Douglas*, 323 F.3d at 1014 (quoting *Lisbon*, 828 F.2d at 765). Defendant's suggestion that we use a reasonable yardstick is attractive for its flexibility, but rulings of the Federal Circuit may call such a shortcut into question.

B. APPLYING *LISBON*

The A-12 contract contemplated a sophisticated research and development project designed to employ the United States' most sensitive technology. Such a contract does not subject itself easily to existing case law from the contract boards.[59] *Lisbon* was a construction case with an identifiable contract closing date. *See* 828 F.2d at 761. Assessing the contractor's progress at termination in *Lisbon* was a straightforward calculation using work accomplished, the work left to be done, and the time left to complete it.

The central issues important to an application of the *Lisbon* standard are work left to be completed and time remaining to complete it. The parties do not agree on the meaning or significance of these potentially dispositive issues. The Circuit did not suggest an appropriate legal standard to apply, or provide a legal basis for choosing among the competing arguments. The court of appeals "le[ft] it to the trial court to determine on first instance the actual performance required by the contract and the amount

[59] The Circuit highlighted a board case in which a fraction was used to show the extent of a contractor's job performance. *See McDonnell Douglas*, 323 F.3d at 1016 (reviewing courts may "compar[e] . . . the percentage of work completed and the amount of time remaining under the contract") (citing *Thomas & Sons, Inc.*, 2001-1 B.C.A. (CCH) P31166 (2000)). The nature of this research and development contract is such that objective evidentiary helps like a percentage of completion are not available.

of time remaining for that performance." *McDonnell Douglas,* 323 F.3d at 1018.

An alternate means of resolving this case would be to choose a closing date offered by the Government. Such dates could be CLIN 58, the latest of the suggested dates, or TECHEVAL, in April 1993. The contractors make persuasive arguments that neither alternative date would be "final." They would not cover the time needed and permitted by contract for plaintiffs to complete performance.[60]

Using CLIN 58 or TECHEVAL is artificial and arbitrary considering the failure to make progress clause. The presumptive purpose of clauses allowing the Government to terminate a contract for failure to make progress is to enable an agency to end a project before the contractors miss a delivery or fail to complete a building on time. The end date may be well before the contract's provision for delivery or completion.[61]

[60] One peculiarity of this alternative is plaintiffs' need to obtain the latest date for measuring performance possible, to give them more time in theory to build the A-12. The latest date possible calls for plaintiffs to show maximum inefficiency in construction. The contractors improve their legal position by contending that the Navy would have had the right, and presumably would have needed to, seek retesting and reconfiguration to achieve the plane it wanted.

[61] Early case law calling for a showing of impossibility or near-impossibility of performance, or abandonment, before allowing default for failure to make progress becomes more understandable in this light. Terminating a contractor months

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The Circuit commented that boards have applied the *Lisbon* test in default terminations for failure to make progress. *See id.* at 1016 n.2. These cases apply only by analogy because they are not failure to make progress cases involving research and development efforts. The reason for this may be that the Government rarely terminates fixed-price research and development contracts for default.[62]

The differences between the facts of *Lisbon* and of this case highlight the difficulties of interpretation. The *Lisbon* test creates problems of application when reviewing default terminations of contracts without completion dates. A case that redefined the required showing in default terminations for failure to make progress is *Universal Fiberglass,* 537 F.2d at 397. Though itself not a research and development case, *Universal Fiberglass* provides useful principles to guide the Federal Circuit's directions.

before the delivery date is appropriate if the contractor has abandoned the project or repudiated the contract; otherwise, termination can be harsh, inappropriate, and unexpected. *See, e.g., Universal Fiberglass,* 537 F.2d at 398.

[62] Research has uncovered only two. *See Appeals of Flight Refueling, Inc.,* 97-2 B.C.A. (CCH) P29,000 (1997) (board found a valid default termination for failure to deliver two prototypes called for as end items on a development contract); *Appeals of ISC/Phonplex Corp. Instrument Sys. Corp.,* 73-2 B.C.A. (CCH) P10,361 (1973) (board held a default termination invalid because the contracting officer had waived the delivery schedule). Neither is similar to this case factually.

C. *UNIVERSAL FIBERGLASS*

Universal Fiberglass considered a supply and service contract for more than 12,000 mail delivery trucks after government approval of a pilot model. *Id.* at 394. The Government warned the contractor repeatedly that failure to meet the delivery schedule would be grounds for termination of the contract. *Id.* The Government accepted Universal's model, but the contractor was unable to meet the first "benchmark" or milestone for delivery of production items. *Id.* The parties agreed to a ninety-day extension. *Id.* Following several additional extensions of time, none of which Universal met, the Government requested that the contractor submit a revised delivery schedule. The GSA Board made two rulings. First, it found that the government's request "impliedly waived plaintiff's failure to progress (so) as to endanger performance of the contract" by asking for the new delivery schedule *Id.* at 397. The Board stated also that Universal's progress failures could not include those actions prior to the Government's request for the revised schedule. *Id.*

On appeal, the United States Court of Claims reversed the board's conclusion with respect to the "failure to make progress implied waiver," stating, "[f]ailure to make progress is obviously something different from failure to deliver, or else the default clause would not provide separately for both." *Id.* at 398. The court found that the concept of waiver was inapplicable in failure to make progress cases:

> [T]he "cure notice" provision for "failure to make progress" terminations is obviously intended to supply the absence of a specific time marker to advise when the minute for default has been reached, such as exists when a contract delivery date has passed without delivery. Thus to have prescribed a new delivery schedule also would have been supererogatory. The "cure notice" served its purpose . . . the contracting officer [had not] learned, from the contractor or any other source, any information to lead him to believe that deliveries would or could ever be resumed. In such circumstances, a unilateral delivery schedule prescribed by him would have been an exercise in futility. . . .

Id.

With respect to the second ruling, the Court of Claims noted that "[p]laintiff's actions, before [the Government's request for a new schedule], indicate a pattern of nonperformance and delay which should not be ignored. Although not justifications for default in themselves, they provide a context for understanding and evaluating plaintiff's continued problems." *Id.*

The Federal Circuit cited *Universal Fiberglass* with approval in the remand, which rejected the impossibility or abandonment requirement to sustain a default termination for failure to make progress. *See McDonnell Douglas,* 323 F.3d at 1015 (Termination for default for failure to make progress affirmed "despite lack of express repudiation") (citing *Universal*

Fiberglass, 537 F.2d at 398). *Universal* also shows that an enforceable schedule is not necessary to determine whether performance is endangered in a failure to make progress case.

Universal holds that a schedule is not necessary because the cure notice supplants the schedule and serves a similar function. The cure notice lets a contractor know that even if performance or delivery is not yet due, the contracting officer believes the contractor may not be making sufficient progress to complete the contract on time. The burden is then on the contractor to advise the Government how it will complete the project on time, according to contract requirements.

The Government did not waive its right to terminate the contractors for default by not reissuing a contract schedule for completion of the A-12. *Universal Fiberglass* holds the Government may call time on a contractor for failing to make sufficient progress without having reissued such a schedule. The Court of Claims' ruling eliminated the need for a schedule in a case such as this one, where the Government issued a notice to cure to alert plaintiffs to their deadline for making adequate assurances. *Universal Fiberglass* showed that default for failure to make progress may be appropriate well before the work is to be completed even in the absence of such a schedule because of the cure notice.

Universal Fiberglass highlights the importance of differentiating between failure to make progress and

failure to deliver. In this case, plaintiffs were terminated for default nearly a year before performance was due. The issues in this case are layered and subtle compared to those of *Universal.*[63] Nevertheless, *Universal* suggests that the contractor defense of waiver as established in *De Vito* is inapplicable in this failure to make progress case. Though the contract may have not had a clear completion date, plaintiffs remained bound by their contractual duty to make progress.

The default clause for failure to make progress does not make reference to a schedule, but allows termination where a contractor is failing to make progress or to prosecute the work "so as to endanger performance." FAR 52.249-9. The question becomes, how would the Government know reasonably whether contract performance was endangered without a contract schedule. *See McDonnell Douglas,* 182 F.3d at 1332 ("Having determined that Contractors were obligated to make enough progress such that contract performance was not endangered, we must now address what progress Contractors should have

[63] The *Universal* court notes that "[p]laintiff was making no progress at all, had never manufactured a vehicle under the new specifications it had agreed to, did not have the necessary parts and could not obtain them and had allowed its labor force to wither away." *Universal Fiberglass,* 537 F.2d at 398. Moreover, the Government had already asked plaintiff for a new schedule and had been rebuffed. "If this situation is not what this failure to make progress clause is about . . . we are at a loss to understand why it was put in the contract at all." *Id.*

made. . . ."). Similarly, how might this court "decide . . . the amount of time remaining for performance" to analyze whether the contracting officer had a reasonable belief there was no reasonable likelihood of timely completion. *McDonnell Douglas,* 323 F.3d at 1017.

Establishing a new enforceable schedule might be the easiest means to determine whether performance has been endangered, but according to *Universal* a schedule is not a precondition to termination. Nevertheless, the Government must have at least a "clear understanding of what needed to be done and how long it would reasonably take." *CJP Contractors v. United States,* 45 Fed. Cl. 343, 378 (2001). Use of this specified schedule of work and time is necessary to gauge the reasonableness of a termination for failure to make progress. Once a court has defined these parameters, it may measure the contractors' progress in light of factors probative of plaintiffs' ability and willingness to perform.

D. THE YARDSTICK

The Federal Circuit implied in this case that a court may choose a reasonable period of performance to use as a measure of progress on the contract. *See McDonnell Douglas,* 182 F.3d at 1332 ("In litigation over a contractor's failure to make progress – unlike a dispute over failure to meet a specific contract requirement or schedule – courts must always determine *ex post* the threshold of performance that a

contractor must meet to avoid endangering performance.") (citing Cibinic & Nash, *Administration of Government Contracts* 930-32). The phrase cited by the Federal Circuit in 1999, "courts must always determine *ex post* the threshold of performance that a contractor must meet to avoid endangering performance," suggests discretion in the trial court to define a yardstick that fairly measures the contractor's performance in the circumstances. The current remand order more clearly allows this: "[W]e leave it to the trial court to determine on first instance the actual performance required by the contract and the amount of time remaining for that performance." *McDonnell Douglas,* 323 F.3d at 1018.

The Federal Circuit ruled in 1999 that "[i]n the A-12 case . . . there was a specified delivery schedule, including the delivery of the first FSED aircraft in December 1991." *McDonnell Douglas,* 182 F.3d at 1332 (citing the record for the original schedule for the eight FSED aircraft and the revised delivery schedule for the same). The Circuit then noted that the A-12 contract "[t]herefore . . . imposed a duty on contractors to make such progress so as not to endanger performance. . . ." *Id.* The court of appeals held that "the contract, throughout its term, embodied a duty to make progress toward the ultimate end item" even though at termination the contract did not "embody [ ] the ultimate end item." *Id.*

The "actual performance required by the contract and the amount of time remaining for that performance" at termination may be a measure such as

the yardstick discussed here. The Federal Circuit opened the door to P00046 or an alternative contract schedule for that purpose. It meets the Circuit's requirement that the court "decide the actual performance that the contract requires and the amount of time remaining for performance," *McDonnell Douglas,* 323 F.3d at 1016 (citation omitted), in absence of the ultimate contract closing date. The P00046 yardstick uses a contract period before the ultimate completion date for measuring performance, but one that encompasses more data for evaluation than a mere milestone. P00046 comprises a series of milestones, each with its own date due and its own standards of completion. The yardstick shows the contractors were behind schedule at termination according to a self-contained series of milestones, not in relation to the entire contract.

The P00046 schedule contained benchmarks for performance and delivery dates that were enforceable and explicit at termination. *See McDonnell Douglas,* 323 F.3d at 1019 ("Based on the information available at the time, the government's unilateral schedule was reasonable."). One benefit of P00046 is that aircraft number eight has a definite date for delivery, not encumbered by a "sliding scale" of time resulting from references to other dates for calculation. For the purposes of measurement, this schedule represents the "entire contract effort."

The parties recognized before termination that the schedule against which the contractors were attempting to make progress was the P00046 delivery schedule. The Navy's purpose in issuing the partial

contract modification was to allow the contractors to continue performing under the FSED contract despite their non-delivery on the first flight deadline in June 1990. Lot I was not a realistic concern for the Government during the months leading to termination. The Navy believed contract dates would be restructured eventually, or the contract would be cancelled. According to Captain Elberfeld, the Navy had "no Schedule for the Lot I aircraft that you would call a realistic schedule."[64] We use FSED aircraft numbers one through eight because realistically, they represent the performance "in play" at termination.[65]

[64] We do not reach the issue of whether the contractors could have been terminated for failure to make progress toward their Lot I obligations under the contract. Captain Elberfeld and the contractors point out that if all of the contract dates were in effect and enforceable simultaneously, the result would have been a nonsensical, overlapping schedule against which plaintiff could not realistically perform. It would have been impossible for the contractors to deliver Lot I aircraft on the dates the parties originally intended.

[65] Captain Elberfeld testified in 2001:

> The schedule for – completing contracts is something that takes sometimes years. Some contracts [take] 10, 15 years before they're closed out, even after the last aircraft is delivered. So asking the schedule to close out contracts is – I don't know what the schedule is to close out the contracts. We had schedules for delivering aircraft, we had schedules for other milestones, like critical design review, preliminary design review, on the major program milestones. But I don't recall the contract saying and the contract will be completed and closed out on this date, as one of the requirements of the contract.

The severable nature of the A-12 contract assists the analysis. That is, the FSED portion of the contract was treated by the parties differently from the production phase, as separate contracts. The Lot I phase was added when the Navy exercised its first production option. Other contractors could have produced hundreds of A-12 aircraft once General Dynamics and McDonnell Douglas completed the research and development phase.[66] Also, the A-12 contract applied different FAR provisions to the FSED and production phases.

The separate FAR default clauses applied to each are significant for our purposes. FAR 52.249-9 authorizing termination for failure to make progress – the provision interpreted by *Lisbon* – applied only to FSED work under the contract. The Production Lots were to be governed by FAR 49.249-8.

P00046 provides an appropriate and "relevant" time period the court may use to consider whether the contracting officer could reasonably have been insecure about the contractors' rate of progress. In the Federal Circuit's terms, this permits the court to "determine[ ] the performance required by the contract and the contract completion date. . . ." *McDonnell Douglas* at 1018.

[66] The Navy asked bidders to form teams partly so the winning contractors could compete against each other for future production contracts.

Having determined P00046 defines "the performance required by the contract" and "the time remaining for contract performance," the next step is to "decide, in light of the information upon which the contracting officer relied" whether he had a reasonable belief that plaintiffs would not perform. *Id.* That is, whether he was "right," objectively.[67] As the court of appeals noted, "this is a determination . . . on which [the Circuit] neither express[es] nor intimate[s] any view." *Id.* at 1018.

We "must take into account *all of the relevant facts and testimony*" in deciding whether default termination was justified. *Id.* at 1013 (emphasis added); *see also id.* at 1017 ("The government owes the contractor no less than an assessment of all of the relevant circumstances when it exercises its discretion under the default clause.") (citing *Appeal of L & H Constr. Co.*, ASBCA No. 43,833, 97-1 B.C.A. (CCH) P 28,766 (Feb. 5, 1997)). "In determining whether a default termination was justified, [trial] court[s] must review the evidence and circumstances surrounding the termination, and that assessment involves a consideration of factual and evidentiary issues." *Id.* at 1014.

[67] The law does not necessarily require that Admiral Morris or any contracting officer be right. The issue is whether "the Government" had in its possession sufficient information that would have justified the contracting officer's nominal concern had it been known. *See infra* note 69.

E. RELEVANT FACTS AND TESTIMONY

"'[R]elevant facts and testimony' include Contractors' statements that they could not meet the contract specifications, the contract delivery schedule, nor complete performance at the specified contract price."[68] *Id.* at 1013. We also consider other "tangible, direct evidence reflecting the impairment of timely completion" in deciding whether the contracting officer acted reasonably, *id.* at 1016, including:

> [T]he contracting officer's testimony and contemporaneous documents. *Id.* at 1016 (citing *Lisbon*, 828 F.2d at 766);
>
> [T]he contractor's failure to meet progress milestones. *Id.* at 1017 (citing *James E. Kennedy, Jr. v. United States*, 164 Ct. Cl. 507, 512 (1964); *Appeals of AAR Corp.*, ASBCA Nos. 16486, 16992, 74-2 B.C.A. (CCH) P 10,653 (Apr. 24, 1974));
>
> [T]he contractor's financial situation. *Id.* (citing *Universal Fiberglass*, 537 F.2d at 395-96); and
>
> [T]he over-all evidence of [the contractors'] failure to prosecute diligently [their] work

[68] The Federal Circuit included these items in the remand order, knowing that they were the primary criticisms against plaintiffs on appeal. *Id.* at 1013. The Circuit's choice of these alleged shortcomings seemed to equate plaintiffs' failure to meet the schedule, their requests for more money, and their problems with some specifications, with legitimate bases for termination.

under the contract. *Id.* (quoting *Discount,* 554 F.2d at 441).

1. Contractors' Statements

"Contractors' statements that they could not meet the contract specifications, the contract delivery schedule, nor complete performance at the specified contract price" are relevant to deciding whether the termination for default was justified. *McDonnell Douglas,* 323 F.3d at 1016; *McDonnell Douglas,* 182 F.3d at 1332. The trial record supplies reasons that a contracting officer might have deemed himself insecure if he were considering the period of performance identified as the "yardstick." For example, plaintiffs' internal schedules showed they would not complete the prototypes covered by P00046 by February 1993. Mr. Anders, General Dynamics' CEO, commented in response to a question from Under Secretary Yockey that the plane would not "fly by 2 January [1991]. All deficiencies cannot be corrected. Can we deliver a satisfactory aircraft for the Navy? Mother Nature won't allow correction of all defects."

McDonnell Douglas' CEO, John McDonnell, said in the same meeting that the contract "has got to get reformed to a cost-type contract or *we cannot do it.* We need some form of Public Law 85-804." (emphasis added). Mr. Lamers, General Dynamics' Program Manager during most of contract performance, agreed that restructure would be necessary.

Six months prior to termination, the contractors projected a twelve to fourteen-month delay in first flight [June-August 1991]. By termination, the contractors' expectations extended first flight to March 1992. TECHEVAL would be in July 1995. Plaintiffs could not meet their own schedule, or their representations regarding schedule. This fact is relevant to the issue of whether the contracting officer could have been concerned whether plaintiffs were making sufficient progress.

Neither contractor would commit to a bilateral schedule without first reaching agreement with the Government regarding outstanding "technical and business" issues. The parties were negotiating solutions to severe schedule slippage at termination. CEO Anders conceded plaintiffs would "do the best we can, and the Navy has to decide if that's good enough." General Dynamics' chief executive officer Pace said the contractors had "major financial problems." To support their request for an equitable restructuring of the contract, Mr. Pace sought to remove "financial strains upon the contractors that might prevent achievement of technical resolution." The parties' A-12 program manager, John Lamers acknowledged that "[s]ome kind of restructure would have to be accomplished if we were to get that aircraft into the fleet."

The contractors' admissions of inability to complete the work according to the P00046 schedule, alleged impossibility of satisfying the design requirements, and concerns about the business issues do not alone

satisfy the Government's obligation to prove default. *McDonnell Douglas,* 323 F.3d at 1015. Such admissions may be sufficient in combination with other factors, however, to show that the contracting officer might reasonably have felt insecure. *See id.* at 1016-17; *McDonnell Douglas,* 182 F.3d at 1328 ("The cost to complete a contract – more particularly, the inability of a contractor to perform a contract at the specified contract price are both fundamental elements of government contracts and are related to contract performance; as such, they are highly relevant to the question of default."). Among the other factors are the contracting officer's testimony and contemporaneous documents.

2. Contracting Officer's Testimony

"The Contracting Officer's testimony and contemporaneous documents are relevant" when deciding whether the default termination was justified. *McDonnell Douglas,* 323 F.3d at 1016.[69] The termination

[69] The role of the contracting officer in deciding to terminate for default was another issue. The contractors contend the Government cannot sustain its burden because the contracting officer did not perform a *Lisbon* analysis, citing the Federal Circuit's remand order:

> Unless the contracting officer had determined the entire effort required under the contract and the time left to complete the contract, it would be difficult, if not impossible, for him to resolve whether there was no reasonable likelihood that the contractor could

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notice to the contractors stated that termination was "based on the Team's inability to complete the design, development, fabrication, assembly and test of the A-12 aircraft within the contract schedule and the Team's inability to deliver an aircraft that meets contract requirements." Testimony by Morris at trial supports these conclusions.

This statement is unclear in context. It does appear to lend support for the contractors' contention. The statement is not easily reconciled with the requirement that this court conduct a *de novo* review of the contracting officer's default termination decision. *Id.* at 1018 n. 3. Factual findings show that Admiral Morris did not calculate a percentage of completion or consider all the circumstances.

The contractor in *Empire Energy v. Roche* argued that *McDonnell Douglas* adopted a special rule for terminations for failure to make progress that departed from the objective analysis requirement. 362 F.3d at 1357. The contractor claimed that "the contracting officer could not properly have terminated for failure to make progress because she [the CO] did not specifically consider whether [the contractor] could have completed the project within the period of excusable delay." *Id.* The Circuit reasoned:

> perform the *entire contract effort within the time remaining for performance.*

McDonnell Douglas, 323 F.3d at 1017 (internal quotation marks and citation omitted).

> We have expressly held that the government must show in termination for failure to make progress cases that it was reasonable for the [government] to conclude that [the contractor] would be unable to complete the project by what the [reviewing court or] Board found to be the proper completion date. . . .
>
> *McDonnell Douglas* is not to the contrary. Indeed, *McDonnell Douglas* demands an objective inquiry, not an evaluation of the contracting officer's subjective beliefs. . . . It requires the court to consider whether the contracting officer's decision to terminate for failure to make progress was reasonable given the events that occurred before the termination decision was made.
>
> *Id.* at 1357-58 (internal citations and quotation marks omitted). The court did not discuss further the excerpt cited above, but *Empire* clarifies the fact that Admiral Morris did not perform a *Lisbon* analysis is not dispositive.

Admiral Morris expressed some reservations about contract completion during his testimony at the 1993 and 2001 trials. As the end of 1990 approached,[70] he was concerned that substantial development on

[70] Admiral Morris testified that concerns about the A-12 Program "started arising very rapidly. . . . Those concerns increased, [he] belie[ved] the risks increased, as we got into the Fall of 1990."

the aircraft had yet to occur. He testified "[t]he contractors were indicating that they were experiencing an overrun that they could not absorb. Cost was obviously a factor and their failure to fabricate components, their failure to meet schedule were clearly impacting cost."

Admiral Morris explained that the contractors' "failure to fabricate parts was endangering performance because . . . I didn't know at that particular time when in fact they would be able, if ever, to achieve [performance of the contract] . . . and I was hearing 'we will not' or 'we could not' . . . " Admiral Morris did not know when the contractors would finish, he said, if ever. However, he did not calculate the contractors' percentage of completion or consider the FAR factors prior to termination. *See supra* notes 42-44 and accompanying text.

The contracting officer testified that in the weeks leading to termination, the contractors

> acknowledged they would not be able to achieve the contract specifications and the contract requirements. . . . [T]hey indicated that they would not be able to meet the delivery schedule that was currently in the contract. And . . . they would not be able to perform the contract without extraordinary relief or additional funding for the contract.

Admiral Morris thought the contractors had not provided him sufficient information about cost or schedule. He quoted the contractors as informing

him, in his words, "I don't know what I can provide, when I can provide it, and I can't tell you how much it's going to cost." The contracting officer summarized, "they basically said they can't perform under the contract and they were in default of it."

Admiral Morris did not commit such concerns to writing as they arose.[71] He encouraged the contractors to continue performing in the face of their alleged default.[72] Admiral Morris did not think the contractors' inability to complete performance on time

[71] Comments to plaintiffs from the contracting officer who preceded Admiral Morris, Mr. Michael Mutty, were an exception. Mutty wrote a letter to the contractors on July 12, 1990, after they did not delivery first flight on time. The letter stated they "failed to deliver the first aircraft as required by the contract. This failure could jeopardize performance of the entire FSED effort." *See infra* p. 68.

[72] Earlier factual findings by this court establish that Admiral Morris did not determine the entire effort required and the time left to complete that contract effort prior to termination. *See, e.g.*, 35 Fed. Cl. at 364 n.6 ("[Admiral Morris] did not know the details of contract performance or the details of the contract specifications."); *id.* at 367-68 ("Morris did not review any A-12 contract documents in preparation for the termination. . . . He did not review documents related to schedule or specifications."); *id.* at 368 ("Admiral Morris testified at trial . . . [that] under [Yockey's] guidelines, [he] couldn't do the one thing that [he] wanted to do, . . . and that was continue the contract. . . ."); *see also supra* note 40. An analysis of Admiral Morris' testimony next to his conduct at the time shows that Admiral Morris was not concerned about the contractors' impairment of timely completion, but only wanted an eventual product for the Fleet.

was fatal to the contract, or to the Program. He wanted a finished product when he could get it.[73]

The Government cites the termination memorandum as a "contemporaneous memorialization" of Admiral Morris' belief that the contractors were in default at termination. A termination memorandum is an in-house document that provides evidence of the contracting officer's reasoning for the decision to terminate. We disregarded the memorandum as evidence of the truth of its contents because of the circumstances surrounding its creation. For example, the Government maintains that the memorandum highlighted the "importance of [the contractors' purported two-year] delay" as a basis to terminate for default. The termination memorandum states in the conclusion, "[a]s a consequence of the team's delay, the Navy would be required to purchase production aircraft before verifying that the aircraft are operationally suitable and effective." Defendant cited this as support for its argument that the contracting officer's termination for default was reasonable.

[73] Admiral Morris was among the A-12's most enthusiastic cheerleaders before he was directed to terminate the contract, and after. Admiral Morris' testimony suggests that he worried about whether the contractors would complete the A-12 project. At termination, however, he was not particularly concerned about deficiencies such as failure to meet the delivery schedule; he did not think they were fatal to the A-12 Program. Admiral Morris' conduct throughout contract performance shows that he acknowledged the risk and the problems with performance, but he continued to encourage the contractors. *See McDonnell Douglas*, 35 Fed. Cl. at 366-67.

Admiral Morris did not reach such a conclusion regarding a two-year delay. Testimony during trial about a two-year delay apparently was meant to coincide with and offer support for the termination memorandum, though its source was an unrelated, land-based aircraft that Lockheed had attempted to build.[74]

Admiral Morris did not testify that he made such a determination or had such a concern. Indeed, he could not have. The A-12 contract schedule obligated the Navy to exercise its options to purchase the production lots before completion of the testing phases irrespective of contractor delay. Eleanor Spector testified that this element of the contract schedule was a risk known before contract award, not "a consequence of the team's delay." The Navy had exercised the option to order six production aircraft, Lot I, in May 1990, before the original first flight deadline the following month.

The only section of the A-12 termination memorandum that addressed the program's schedule "stops short of a prediction." *McDonnell Douglas,* 35 Fed. Cl. at 367 n.12. Ms. Olsen and Admiral Morris neglected to fill in the blank provided by the P-7

[74] The language quoted in the termination memorandum was taken from a termination memorandum used for another project, the P-7. Ms. Olsen had little time to craft a memorandum specific to the A-12 that busy Monday morning, January 7, 1991; this was the day the Government's half-billion dollar advance to plaintiffs was due. *See supra* pp. 38-39.

memorandum: "Since June 1990, the team has consistently reported its delays; and the Navy's independent review confirmed that, given the state of the team's development efforts, delivery of aircraft and completion of related contract requirements could occur no sooner than ." [*sic*] This confirms that Admiral Morris did not conduct an analysis of the time it would likely take the contractors to complete the entire effort. Asked about this key omission during trial, Admiral Morris admitted, "obviously I blew it."

Admiral Morris wanted the opportunity to resolve the issues without extraordinary relief. At trial, he agreed that the contractors were in default and he testified he thought they should be terminated for default. The Federal Circuit interpreted this testimony as evidence plaintiffs were seriously in default at termination. *See McDonnell Douglas,* 182 F.3d at 1327 ("[T]he trial court's finding that the Navy went to great lengths to preserve the A-12 program suggests that it would not have terminated the contract but for its belief that Contractors had breached the contract or would not perform the contract.").[75]

[76] Admiral Morris did not want to terminate the contract; he wanted the opportunity to continue despite the concern he expressed at trial that plaintiffs were in default. He would have attempted to work with the contractors even without a "bail-out" or other relief. Given his testimony during trial and contemporaneous records, the Government's insistence that he

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The contracting officer's testimony and contemporaneous documents do not provide sufficient evidence to prove justifiable termination for default. Admiral Morris' beliefs are not conclusive, however, but only a factor to consider upon review. *See McDonnell Douglas,* 323 F.3d at 1016 (holding "a court's review of default justification does not turn on the contracting officer's subjective beliefs but rather requires an objective inquiry."). "[We] may also consider other factors usually relied upon by courts and contract boards, such as .... the contractor's failure to meet progress milestones." *Id.*

3. Failure to Meet Milestones

The Federal Circuit ruled that concern about plaintiffs' missing a milestone is not a proper basis for termination. *Id.* at 1015 (citing *Lisbon,* 828 F.2d at 765). However, missed milestones may be considered in conjunction with other contractor shortcomings in determining whether the contracting officer made a reasonable decision to terminate for default. *Id.* at 1016-17.

The contractors did not deliver the June 1990 first flight on time according to the original schedule.

believed the contractors were seriously in default at termination seemed to put Admiral Morris in an odd position. The Circuit noted, however, that the Navy's and Admiral Morris' desire to continue the contract "does not thereby waive [the Government's] right to terminate for default." *McDonnell Douglas,* 182 F.3d at 1327.

They would not have delivered first flight on the revised schedule either. Missing a milestone could cause delay in the "building block" sequence of construction, irrespective of findings that the contractors were using their best efforts to improve and advance the project. Defendant points out that the contractors had missed several milestones by termination in December 1990-January 1991. CDR was scheduled to be completed by July 1989 (CLIN 0003). In 1989, the CDR was divided into a four-phase process. The third phase was still open at termination, and the fourth would not be completed until July 1991.

The contractors missed delivery of two prototypes before the Navy issued P00046, the modified contract schedule. The contractors admitted they would not meet various milestones in the future. Plaintiffs claim that no missed milestones were outstanding as of termination because first flight and the CDR milestones were waived through contract modifications. They contend that missed milestones have no legal significance in any event, because the contract had no binding completion date.[76]

The Navy did not terminate the contract when it became apparent CDR would not be completed on time; nor did it terminate when plaintiffs missed the

[76] This is one indication of the importance of their interpretation of the remand order to the contractors; it has wide implications.

original first flight date. Missed milestones do not necessarily give the Navy such authority. *See Appeals of Ubique, Ltd.*, 72-1 B.C.A. (CCH) P 9,340 (1972) (Where the date contractor was due to present prototype for government inspection passed without delivery, "the Government could not have summarily terminated [contractor] for default").[77] Missed milestone dates may, however, be relevant. *See Universal Fiberglass*, 537 F.2d at 397 (Missed milestones "indicate a pattern of nonperformance and delay which should not be ignored. Although not justifications for default in themselves, they provide a context for understanding and evaluating plaintiff's continued problems"). Such information should be relevant if we consider whether a reasonable contracting officer might reasonably have been concerned about plaintiffs' ability to complete the contract on time.

4. The Contractors' Financial Situation

The contractors' financial situation, "particularly, the inability of a contractor to perform a contract at the specified contract price" is relevant to the question of default. *McDonnell Douglas*, 323 F.3d at 1017; *McDonnell Douglas*, 182 F.3d at 1328. We ruled in 2001 that "[n]either the cure notice nor the default

[77] Perhaps the Government could not have terminated the contractors for failure to perform the work under the contract within the time specified, or any extension, *see* FAR 52.249-9(a)(1)(i), but not for an alleged progress failure that requires proof of "endanger[ed] performance." FAR 52.249-9(a)(1)(ii).

notice suggests that the Navy thought the contractors were financially unable to complete the contract" and that "plaintiffs' financial condition was not endangering performance of the A-12 contract." *McDonnell Douglas,* 50 Fed. Cl. at 320-21. The Government did not terminate plaintiffs for default on that basis. *Id.* Notwithstanding these conclusions, we may consider the contractors' financial situation as part of the overall reasonableness inquiry mandated by the appeals court.[78]

Government officials close to the contract, including the Secretary of Defense, believed P.L. 85-804 was necessary to go forward with the A-12. This would permit a contract restructure or a "bailout," if needed. Morris did not close the door to negotiating a new contract without it, but he became more pessimistic after the notice to cure. He encouraged plaintiffs to address the cost overrun situation in response to the notice. He felt cost was a "real issue." Ms. Spector's testimony showed she agreed with Admiral Morris: "[W]hen a contractor has financial problems it's unable to do work-arounds. It's unable

[78] The Federal Circuit discussed the issue of financial ability in the remand after acknowledging that this court "declined to base its determination of justified default on Contractors' alleged financial inability to perform the contract." *McDonnell Douglas,* 323 F.3d at 1011. It is unlikely the appeals court would have directed consideration of plaintiffs' financial ability if that factor could not be a part of the "tangible, direct evidence" to which we should refer on remand.

to do new technical approaches that may be necessary to solve a problem."

The contractors' requests for restructure of the A-12 contract are relevant too. The contractors expressed to the Navy in the Summer of 1990 and several times later that Fall their belief that insufficient funds were obligated to perform. Mr. McDonnell lamented: "The fixed-price nature of the contract precluded good management." He claimed that the A-12 contract "has got to get reformed to a cost-type contract or we cannot do it."

The Government did not terminate for default because of plaintiffs' cash flow problems. *McDonnell Douglas,* 50 Fed. Cl. at 320-21. Admiral Morris acknowledged he was not in a position to make decisions about contractors' financial position. *Id.* The contractors' requests to restructure the contract were not declarations of financial inability or unwillingness to perform. *Id.* However, evidence regarding how perceived financial problems may affect performance on the contract, such as statements by Admiral Morris, Ms. Spector, and Mr. McDonnell, are "highly relevant to the question of default." *McDonnell Douglas,* 182 F.3d at 1328. Representations of the contractors' grave financial position from parties close to the contract in the months prior to termination, support a finding of justifiable default measured by the P00046 schedule.

5. The Contractors' Failure to Prosecute

We may consider "over-all evidence of [the contractors'] failure to prosecute diligently its work under the contract." *McDonnell Douglas*, 323 F.3d at 1017 (quoting *Discount*, 554 F.2d at 441). This category goes to the merits of plaintiffs' performance, and it serves as a summary of matters discussed earlier.

The contractors' history of performance in general can be said to have involved delays and unresolved issues. Plaintiffs experienced a number of delays and problems with technical issues throughout contract performance.[79] Admiral Lockard emphasized that plaintiffs were having serious difficulties manufacturing aircraft parts. Contractors admitted after the June 1990 first flight date passed without delivery that they were experiencing a twelve to fourteen-month delay. TECHEVAL was scheduled to occur at least eighteen months after the April 1993 date in the original contract. The contractors acknowledged that all delivery dates in the Master Program Schedule would be delayed.[80] The contractors

[79] The nature of research and development contracts is such that most of the work normally happens during earlier periods of performance than is typical of construction or delivery contracts.

[80] This evidence shows that the contractors recognized performance problems during development of the A-12. The Master Program Schedule, however, has little meaning otherwise, because it includes only the original contract dates. These were not enforceable at termination.

had not delivered two aircraft on time when the Navy unilaterally modified the delivery schedule in August 1990.

Despite delays, the contractors continued operations. They were spending $120 to $150 million of their own money every month. They were committed to performing the A-12 contract until the date of termination. The contractors were encouraged to spend their own money in part by the Navy's A-12 Program Review that found "[n]o major 'showstopper' technical issues." At termination, the Navy noted "a modest uncertainty in first flight date," but also asserted that "system performance is good with excellent overall operational capability." The Navy acknowledged contractor delays but encouraged the contractors to continue. The Navy elected to go forward during the Design Review Boards with knowledge that the A-12 aircraft would not meet all specifications in the original contract. The contractors' strict conformance with each specification was not a principal concern of the Government's then. Some specifications were "chinning bars," set high to insure that the Navy would get the best aircraft possible.[81]

Plaintiffs did not intend to abandon the project, though a showing of abandonment is not necessary to

[81] The Navy may have been unsure what to include as performance specifications in the A-12 contract at the outset. This would be understandable, as no one had designed a stealth fighter that would land on an aircraft carrier.

establish failure to make progress. *See McDonnell Douglas,* 323 F.3d at 1015. Mr. McDonnell testified that "[t]he U.S. Navy was our biggest and most important customer. This was the program of the future for the U.S. Navy. . . . And so the biggest program for the longest future and our biggest customer, you don't stop performing on something like that."[82]

The test for reviewing the contracting officer's decision does not, however, include solely the effort expended by the contractors in attempting to meet the contract requirements. This court explained in a recent failure to make progress case that "[i]f that was our ultimate goal, the court would simply state that the record evidence establishes that [the contractors] worked very hard on the contract. . . . [Assessing whether the contractor failed to diligently prosecute the work] requires that we look at the results of the contractor's efforts. . . ." *Aptus Co. v. United States,* 61 Fed. Cl. 638, 657-58 (2004), *aff'd sub nom. Lin v. United States,* 159 Fed. Appx. 186 (Fed. Cir. 2005), *cert. denied,* 547 U.S. 1113, 126 S. Ct. 1921, 164 L. Ed. 2d 666 (2006).

[82] Trial notes confirm that this testimony, which otherwise may strike a finder of fact as self-serving, was entirely credible. Mr. McDonnell's testimony was honest and truthful with respect to his intentions and those of his company. Admiral Morris' contemporaneous impression of a January 1991 meeting with the CEOs was, "[b]oth companies committed." At the same meeting, he noted Under Secretary Yockey's agreement that the contractors were "mov[ing] in the right direction."

Government officials decided uncertainty regarding schedule and cost was causing problems with continuing the Program. That is, the contractors' efforts were not "good enough." Government witnesses testified they believed plaintiffs were operating woefully behind schedule, and evidence supports their concern.

Admiral Lockard reported to Secretary Cann in September and November 1990 that he thought the contractors' progress was unsatisfactory. He testified about a "lingering technical concern" that first flight would be difficult to predict in early November 1990. He could not predict with accuracy when the first plane would fly until all the composite parts were successfully built, and getting those parts built created continuing difficulties. After a meeting of the Design Review Board for the third phase of CDR, he felt "hopeful" that he could declare CDR a success and approve the A-12 design. He concluded "it was going to take a considerable amount of time for [the contractors] to figure out the problems that they were having [building composite parts repeatedly,] then correct everything to make it work."

Admiral Lockard explained: "I couldn't give my boss or anyone else a date we felt with certainty that we could stand up and say, they will be ready on this date."[83] Captain Elberfeld, Admiral Cook, Admiral

[83] Admiral Lockard was the Chief Engineer of NAVAIR. He met with Admiral Morris near the end to discuss "the technical

(Continued on following page)

Lockard, and Secretary Cheney all thought the contractors were in material breach.

Captain Elberfeld was concerned about the contractors' acknowledgment, beginning in Spring 1990, that they would be at or over the ceiling price. He thought this jeopardized the contractors' performance. The contractors' cash flow problems led to "cost cutting efforts like reducing staff, eliminating overtime, quick fixes that address and would remedy a cash flow situation." Captain Elberfeld learned in July 1990 that this meant removing 110 people from the A-12 program, which would result in more schedule problems. He said, it would cause "a longer process to get product that may not be the product that we desire or need."

Admiral Cook succeeded Captain Elberfeld as the A-12 Program Manager prior to termination. Admiral Cook had been "convinced . . . [that] the program was not executable" by the first of the CDR Phases. Like Admiral Morris, he wanted a chance to continue building the A-12 because he thought it was "needed [for the Fleet]." However, he thought that a "bailout" was necessary for the contractors to be able to continue performing under the contract.

issues, could we get them resolved, if we could find a way to satisfy the business arrangements, to get the contractors to do the work. . . . We were unsuccessful in finding a way to get the contractors to do the work."

The concern among Navy officials throughout 1990 was first flight. They all knew the contractors would not meet the first flight milestones in June 1990 and December 1991, but it remained a troublesome issue because of the importance attached to this significant milestone. The following comments are taken from weeks of testimony and from a voluminous documentary record. They are necessarily selective, but they provide a flavor of the concerns that constitute evidence the Circuit discussed:

> Admiral Cook: The Navy would not "get eight FSED aircraft or anything of use . . . without a bailout. . . . Period."

Admiral Lockard: Successful outcomes pursuant to the agreements reached at CDR were contingent upon resolution of outstanding business issues. Admiral Lockard testified that the contractors' failure make progress on the structural components – i.e., "big bones," – was critical to the contract. He found that "[the contractors] were not making progress in building [the planes] . . . they were severely behind. . . and we couldn't assemble the first airplane until they were able to build these parts successfully." Admiral Lockard acknowledged that the contractor's difficulties in manufacturing parts did not suggest that "they could never build the parts; I just thought that it was going to take a considerable amount of time for them to figure out the problems" and correct them. He believed the contractors could complete the contract, but that it would take longer than anticipated.

Admiral Morris was aware of Admiral Lockard's statement, "technical resolution on the airplane has been reached." He knew of Admiral Lockard's belief that the parties "were on the way to a satisfactory CDR conclusion [and] [t]he contingencies on the RFA close-outs are vital to the success of the program." Admiral Lockard also notified Admiral Morris that the contractors had not complied with the "contingencies," however. Secretary Cann, whom Admiral Lockard briefed regarding this noncompliance, responded that he was concerned about the contractors' management structure.

Captain Elberfeld: The contractors stated they would be "unthinkably" over the A-12 contract fixed-price ceiling; their internal "worst case estimate could bankrupt both corporations." The contractors' cost-cutting efforts to avoid bankruptcy "lead to more corner-cutting and more incomplete effort and basically a longer process to get a product that may not be the product that we desire or need for the Navy."

Eleanor Spector: The contractors were spending $120 to $150 million per month. Their next progress payment would be August 1991, and they could not sustain a negative cash flow, "particularly considering the drains on the programs." Public Law 85-804 was the only way to go forward; absent restructuring, the Navy would never receive a usable aircraft.

Michael Mutty, the contracting officer of the Naval Air Systems Command, testified that the contractors were not meeting their requirements

under the A-12 contract. On July 12, 1990, Mutty sent a letter to the contractors expressing

> serious concern regarding [the contractors'] performance under the A-12 contract. . . . [Y]ou failed to deliver the first aircraft as required by the contract. This failure could jeopardize performance of the entire FSED effort. Neither in your letter nor afterward have you provided any basis on which I could conclude that any of your obligations under the contract should be excused.

This letter gave the contractors notice of the Navy's concern over their lack of progress, their failure to meet contract requirements, and their possible termination. If Admiral Morris did not communicate his unease over A-12 to plaintiffs, or commit it to writing, Mutty did. He conveyed to the contractors "serious concern" regarding timely contract completion.

The issue on remand is whether a reasonable contracting officer, basing his termination decision on tangible, direct evidence reflecting the impairment of timely completion, could reasonably have decided to terminate the contract for default. The Circuit described factors to consider in answering this question. These include the contracting officer's testimony and contemporaneous documents, the contractors' failure to meet progress milestones, the contractors' financial condition, and other pertinent circumstances surrounding the termination decision.

This Opinion includes mitigating factors for plaintiffs in the discussion above and throughout the Opinion, in an effort to give a true picture of the issues a finder of fact faces in this case. Additional such factors are explained below. Overall, however, evidence of record supports a conclusion that the Government was justified in terminating the contract for default for failure to make progress.

III. CONTRACTORS' DEFENSES

The Government found no reasonable likelihood that McDonnell Douglas and General Dynamics would complete their contract obligations within the specified contract time. The default termination must stand unless the contractors prove the default was unlawful or excused. The contractors have the burden of proving such defenses. *RFI Shield-Rooms,* ASBCA Nos. 17374, 17991, 77-2 B.C.A. (CCH) P 12,714 (Aug. 11, 1977).

The contractors assert three interrelated defenses: (1) the Navy waived the A-12 contract delivery schedule; (2) if the original schedule was not waived, the P00046 modification created a nonsensical overlapping schedule to which the contractors could not be bound; and (3) the contract had no completion date for the "entire contract effort" at termination, leaving no possibility the contracting officer reasonably concluded the contractors would not complete the work on time. These are intertwined with plaintiffs' arguments that the Government could not meet its burden under *Lisbon.*

A. WAIVER OF DELIVERY SCHEDULE

Plaintiffs maintain that defendant waived or "disestablished" the original schedule to completion when it allowed the contractors to continue working beyond the June 1990 delivery date, and reset only a part of the work required under the original contract. They cite the remand to support this contention. *See McDonnell Douglas,* 323 F.3d at 1019 (discussing *DeVito,* 413 F.2d at 1154-55). *DeVito* held that

> [w]here the Government elects to permit a delinquent contractor to continue performance past a due date, it surrenders its alternative and inconsistent right under the Default clause to terminate, assuming the contractor has not abandoned performance and a reasonable time has expired for a termination notice to be given. This is popularly if inaccurately referred to as a "waiver" of the right to terminate. . . . The necessary elements of an election by the non-defaulting party to waive default in delivery under a contract are (1) failure to terminate within a reasonable time after the default under circumstances indicating forbearance, and (2) reliance by the contractor on the failure to terminate and continued performance by him under the contract, with the Government's knowledge and implied or express consent.

413 F.2d at 1153-54.

Plaintiffs assert that the Government waived all dates in the original schedule by encouraging the

contractors to continue work after they missed the June 1990 first flight deadline, and that the Government must reset the entire schedule in such circumstances to reestablish time of the essence.

Defendant's position is that *DeVito* addresses the Government's burden to reestablish missed delivery dates, but it does not require the Navy to reestablish dates that have not yet come to pass. It argues,

> [n]othing in the law forced the Navy to decide on July 1, 1990, whether to terminate the A-12 contract immediately, or grant plaintiffs a windfall of resetting the entire schedule in response to plaintiffs' being late on the first delivery. . . . Government contractors do not gain contractual leverage via their defaults.[84]

We agree. The effect of plaintiffs' argument is th Navy should anticipate the need for reestablishing new dates at least five years into the future, and we and do not view the *DeVito* waiver rule so broadly as plaintiffs claim. At most, the court of appeals' reference to *DeVito* meant that Government waived its right to terminate plaintiffs for missing the original first flight date in June 1990 by "permit[ting] [the] delinquent contractor[s] to continue performance past

[84] This is a version of the strawman fallacy, but it shows why a definable and measurable schedule is the more reasonable and pragmatic means of resolving this issue.

[this] due date." *McDonnell Douglas*, 323 F.3d at 1019.

A waiver generally is considered an intentional relinquishment of a legal right. A finding under *DeVito* that the Navy waived its right to terminate plaintiffs for default in this case would assume irrational behavior on the Navy's part.[85] That is, the Navy must have intentionally relinquished its right to enforce the entire schedule by issuing P00046, then chosen to reset only the missed delivery date and the remaining FSED dates. P00046 contains boilerplate language that may protect against such a result. Having stated new dates for the eight aircraft, the modification stated, "all other terms and conditions of the contract remain unchanged."

A showing of detrimental reliance is necessary to prove waiver of a schedule. *DeVito*, 413 F.2d at 1154. We find no such prejudice to plaintiffs. On July 12, 1990, the contracting officer advised plaintiffs in writing that their failure to meet first flight "could jeopardize performance of the entire FSED effort." The Navy asked the contractors to submit plans to meet the schedule for the entire program. Plaintiffs did not respond. The Navy recommended a schedule

[85] We do not overlook the possibility that the Navy, like many contractors, could have fallen into a trap for the unwary and suffered unintended consequences. Contractors are presumed to know and understand the court-driven complexities of their actions during contract performance; the Government should be equipped to accept those risks as well.

that projected delay in all delivery dates, including an eighteen-month slip in TECHEVAL. Still, plaintiffs would not agree to a bilateral modification. Plaintiffs were well aware then that the Navy was concerned about schedule issues and that the entire program could be cancelled by the Department of Defense.

Most of the cases to which plaintiffs refer in support of the schedule waiver theory are factually and legally distinguishable. *See, e.g., SIPCO Servs. & Marine, Inc. v. United States,* 41 Fed. Cl. 196 (1998); *Robert E. Moore Constr.,* 1990-2 B.C.A. (CCH) P 22,803 (1990). In *SIPCO,* this court found the agency waived the contract completion date by allowing the contractor to continue deliveries, though deliveries were late. 41 Fed. Cl. at 211. Moreover, the court found that the Government's unilateral modification, which set a new contract completion date, was not "reasonable from the standpoint of the performance capabilities of the contractor." *Id.* In *Robert E. Moore,* the Government did not satisfy its burden of proving reasonableness of a new delivery date after it had waived an older date. 90-2 B.C.A. (CCH) at P 22,803. The parties were therefore operating without a delivery date, thus the termination for default for failure to deliver was not justified. *Id.* These and similar board decisions are examples of a Government waiver after contractor default.

A reason it is difficult to apply such cases to this one is the important distinguishing factor in *DeVito* and other cases finding waiver – timing of the missed delivery date. In *DeVito,* the contractor missed the

final delivery date; waiver occurred after the contractor delivery default. The Government waived an old delivery deadline by not issuing one, leaving the contractor without notice of how much time was left for performance. Whether a notice to cure or a reestablished schedule of completion, these cases seem to address a similar commonsense requirement-notice.

Plaintiffs' argument that the Government waived its right to terminate tends to contradict the law of this case. They have not addressed the Circuit's implied ruling that the Navy reestablished its right to terminate for default by issuing P00046. *See McDonnell Douglas,* 323 F.3d at 1019. If the court of appeals had found that the Navy waived the entire schedule, it would not have remanded the case for this court to "determine[ ] . . . the contract completion date." *Id.* at 1018.

The effect of plaintiffs' waiver argument is that defendant's failure to establish an ultimate contract completion date disposes of the Government's right to terminate. Not having established or reset a schedule for the entire contract after the *DeVito* waiver in 1990, defendant could not use failure to make progress as an incidence of default during the contract's pendency. This would be a harsh result. More importantly, however, such an interpretation would neutralize the Circuit's discussion of "tangible, direct evidence" needed to consider whether termination was justified. *McDonnell Douglas,* 323 F.3d

at 1017. We do not interpret the Circuit's remand or existing case law so strictly.

B. OVERLAPPING SCHEDULE

Plaintiffs assert that if the original delivery schedule to contract completion was not waived, the Navy's issuing P00046 created an overlapping schedule impossible for the contractors to meet. Under the original schedule, the fourth aircraft of Lot I and modified first flight would apparently be due the same month, December 1991. *See supra* note 21.

The Government points to the Changes Clause of the contract, which requires plaintiffs to inform the Navy within twenty days of any actions or inactions they consider to be changes to the delivery schedule. Plaintiffs did not file such notifications. After plaintiffs missed the delivery date in June 1990, the Navy asked them to propose a new contract schedule. They refused, because for the contractors, "global issues" facing the A-12 program in mid-1990 took precedence. Plaintiffs did not want a binding schedule until these matters were resolved. According to defendant, plaintiffs therefore "acquiesced" in the continued enforceability of the original schedule.

The overlapping schedule offered by the Government as a basis for assessing default is unreasonable and likely unenforceable. The A-12 contract was designed as a long-term research and development effort, structured so that each period of performance built upon preceding work. Progress cannot be

assessed in relation to milestones, but only in comparison to the entire contract effort. *See McDonnell Douglas,* 323 F.3d at 1016. The Government contends that the Lot I schedule remains in effect because that portion of the original contract was not changed by P00046.[86] In other words, the Lot I schedule remains in effect and plaintiffs would not make the deadlines provided there. This means production aircraft would be due before some of the prototypes. Application of the contract in that manner would be nonsensical.

Plaintiffs other argument on this issue is breach of contract. The contractors assert that defendant's argument regarding enforcement of the Lot I schedule as drafted breaches their contract right to a "sequential" delivery schedule. If the contract guaranteed plaintiffs a sequential schedule, however, P00046 itself would be unreasonable and unenforceable. Without the modification, the contract's sequential order would remain. Apparently, plaintiffs made a version of this argument to the Federal Circuit and it was rejected. The appeals court ruled

[86] The P00046 modification does not have a milestone built in for completion of the contract or a date at when the fourteenth and final aircraft would be delivered. The modification addressed only the schedule for delivery and testing on the first eight planes. Presumably, Lot I would have begun after the contractors delivered eight prototypes to the Navy's satisfaction. However, the schedule offered by the Government set delivery for the first FSED airframe in December 1991 and plane nine, the first aircraft in Lot I, remained due June 1991. Lot I would commence six months before the first test aircraft was to be delivered.

that P00046 was reasonable and enforceable. *See Id.* at 1018-20.

The Navy probably could not have enforced the Lot I delivery dates, but it does not seem necessary to get that far into the analysis. The yardstick approach employs a schedule that we know to be reasonable and enforceable because the Circuit has so ruled – that is, P00046.

The *Lisbon* review takes a realistic look at the schedule that the parties were working toward at termination. Failure to make progress against an overlapping schedule would not be a reasonable basis for default. Not only would it be unfair, but also it would be inimical to the contract's purpose, to design, then manufacture and test successively more technically complex stealthy aircraft for the Navy's fleet. This is the main reason that we are left with the "yardstick approach."

C. CONTRACT COMPLETION DATE

This Opinion has addressed plaintiffs' arguments that the Navy waived the contract schedule and that the schedule was rendered "nonsensical" by the P00046 change order.[87] Plaintiffs offer the additional

[87] The schedule for design, manufacture, testing, and production of the A-12 aircraft was to be performed in sequence. This is typical of research and development contracts, as compared to construction contracts or contracts calling for periodic delivery of identical end items. McDonnell Douglas'

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claim that the contract had no completion date for the "entire contract effort" at termination, leaving no possibility that the contracting officer reasonably concluded the contractors would not complete the work on time.

No one expected to enforce the Lot I schedule. Plaintiffs base their theory in part on this finding. *See McDonnell Douglas*, 50 Fed. Cl. at 317-18 (citing Captain Elberfeld's testimony). If the Circuit had affirmed the ruling that P00046 was reasonable and enforceable because the entire contract had no schedule to completion, the appeals court would not have asked us in the same opinion to find a contract completion date. Captain Elberfeld's comments meant only that no one was considering Lot I or TECHEVAL, or any other dates at termination. Only P00046 was on the table. This court's review of "events, actions, and circumstances leading to termination" must exclude considerations of what might have been expected up to five years later.

The contract had no completion date at termination, seemingly leaving the court without a basis for finding a reasonable belief on the part of the contracting officer that the contractors would not

arguments assume that this sequential approach to performance was a contract requirement. *See McDonnell Douglas*, 35 Fed. Cl. at 362 (noting that "[e]ach FSED aircraft would test different characteristics of the A-12; stealth capabilities would be verified in the 'fully capable, fully equipped' eighth aircraft that would serve as the basis for the production lots.").

complete the work on time. However, the appeals court did not rule that we should reject the *Lisbon* test if no contract completion date applies. The contractors acknowledge that such a reading is merely implicit in the remand decision. The Circuit was aware of both parties' interest in a contract completion date, which apparently was argued strenuously on appeal. The Federal Circuit did not suggest that *Lisbon* would not apply in such event, but explained repeatedly that the trial court should apply *Lisbon*.

Many cases to which plaintiffs refer are not helpful, given our facts. They involve the complete absence of any schedule for the contractual work.[88]

[88] *See Lanzen Fabricating, Inc.*, 1993-3 B.C.A. (CCH) P 26,079 (1993) (Government's right to terminate for default may be defeated by government conduct after default "which either condones the default, or encourages or asks for continued performance, or fails to set a new delivery schedule"); *M.V.I. Precision Machining, Ltd.*, 1991-2 B.C.A. (CCH) P 23,898 (1991) (default termination of supply and service contract overturned because the Government did not establish a "valid and subsisting delivery schedule" and the contractor therefore "could not be late in making delivery in accordance with . . . [a] nonexistent schedule or in making progress under such [a] nonexistent schedule"); *Motorola Computer Sys.*, 1987-3 B.C.A. (CCH) P 20,032 (1987) (default termination of supply and service contract reversed upon finding that "with no performance schedules in existence, in accordance with which [the contractor's] progress could be measured, the termination . . . was improper") *Humphrey Logging Co.*, 1985-3 B.C.A. (CCH) P 18,433 (1985) (default termination of construction contract overturned because the delivery schedule was waived and no schedule ever reestablished). Where the contract expires but the contractor

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Plaintiffs also argue *Electronics of Austin,* a Board case similar to *McDonnell Douglas. See Electronics of Austin,* 1986-3 B.C.A. (CCH) P 19,307 (1987). In *Austin,* the Government had waived the performance schedule, and "there was no time frame within which [the plaintiff] had to perform." *Id.* For that reason, the Board found plaintiff could not be terminated for failing to make progress. The Federal Circuit distinguished *Austin* from this case because in *McDonnell Douglas,* the appeals court found a "specified delivery schedule." *See McDonnell Douglas,* 182 F.3d at 1332. The schedule "includ[ed] the delivery date of the first FSED aircraft in December 1991. . . . Therefore, the [A-12] contract imposed a duty on Contractors to make such progress so as to not to not endanger performance." *Id.*

The Circuit ruled that plaintiffs had a duty to make progress because the contract contained "a specified delivery schedule, including the delivery of the first FSED aircraft in 1991." *Id.* This ruling supports the yardstick approach discussed above. If plaintiffs were obligated to make progress against the portion of the contract that was enforceable at the time, the P00046 modified schedule was an appropriate measure of that performance. *See McDonnell Douglas,* 182 F.3d at 1331-32 (ruling that plaintiffs were required to make progress toward an "ultimate

continues to work with no new completion date to measure progress, a much simpler analysis presents itself.

end item" if not to contract conclusion, where funds had not been obligated to the entire contract).

IV. ADEQUATE ASSURANCES

The Government raises plaintiffs' lack of adequate assurances again, apparently on the basis that such a failure operates as an independent incident of default. That is, the contractors did not provide the Navy adequate assurances of timely performance in response to the cure notice. The judgment in this case moots defendant's alternative argument that plaintiffs did not provide adequate assurances to the contracting officer after receiving his notice to cure. This court's views on that issue have not changed. The findings of fact and conclusions of law related to adequate assurances are incorporated herein by reference. *See McDonnell Douglas,* 50 Fed. Cl. at 321-23.

Defendant believes the contractors' admission that they would not meet the delivery schedule or certain technical specifications required by the contract demonstrates lack of adequate assurances as a matter of law. We ruled in 1996 that the contractors did not repudiate the contract. *See McDonnell Douglas,* 35 Fed. Cl. at 377. The Government did not view the contractors' actions in this manner. *Id.* Admiral Morris did not believe that the contractors would not perform; he wanted an opportunity to work out the problems "within the boundaries of the contract." *Id.* n.31. Witnesses for the Government and

for plaintiffs confirmed that the contractors intended to complete the contract.

A traditional repudiation claim required proof of a "positive, definite, unconditional, and unequivocal manifestation of intent . . . not to render the promised performance when the time fixed . . . by the contract shall arrive." *Id.* (quoting *Cascade Pac. Int'l v. United States,* 773 F.2d 287, 293 (Fed. Cir. 1985)). The Government points out that since the 1996 ruling, a new view of anticipatory repudiation has emerged. The modern rule acknowledges the Government's right to obtain assurances of timely performance in response to a justifiable cure notice and to declare the contractor in default for failure to provide such assurances. *See Danzig v. AEC Corp.,* 224 F.3d 1333 (Fed. Cir. 2000).

Danzig was an issue during the last trial. We discussed its application to this case at 50 Fed. Cl. at 321-23, pointing out that "[n]one of [*Danzig*'s] facts is present here." *Id.* at 322. Pertinent excerpts from that discussion follow:

> In response to the cure notice issued by the Navy, the contractors stated that they were committed to the program and were providing a response to the concerns raised by Admiral Morris. The contractors addressed Admiral Morris' cure letter and provided additional information about the progress of the program. Certain specifications and delivery schedules would not be met, but the contractors explained why this was so. They

alleged that certain requirements were impossible to satisfy, for example. Unlike AEC, McDonnell Douglas and General Dynamics continued to perform until they were terminated for default. They were spending between $120 and $150 million per month on the A-12 contract. . . .

Admiral Morris did not view the contractors' response to the cure notice as failing to provide adequate assurances.

The Government points to the contractors' request for equitable restructure of the A-12 contract as evidence that their financial situation would not permit the contractors to complete this contract. The proposal for restructure was not a response to the cure notice. It was a request for financial assistance. It was not included with the cure notice response but was a separate document with a separate cover sheet. Admiral Morris took notes at a January 2, 1991 meeting with the contractors. He records Mr. Anders, Chairman-Elect of General Dynamics, as stating, "[b]oth companies committed." [Under Secretary] Yockey agreed that contractors were "mov[ing] in the right direction." Failure to give adequate assurances does not appear in the termination notice as a ground for default. While the contractors wanted a restructured program they did not state they would suspend work on the A-12 contract. John McDonnell, CEO of McDonnell Douglas, testified that the contractors "weren't about

> to abandon [the A-12 contract]." Admiral Morris testified that he "would not have terminated the contract on the 7th of January if I got the authority to give it one more try."
>
> Plaintiffs did not repudiate this contract. Admiral Morris did not terminate the A-12 contract because the contractors did not give adequate assurances.

Id. at 322-23.

Following this court's ruling on adequate assurances, defendant raised the issue twice before the Federal Circuit. Defendant wrote:

> Government officials were entitled, as a matter of law, to rely upon the assurances of the contractors' most senior management that .... they would not perform the existing contract in determining whether the program should be continued, as well as whether the contractors were in default. . . . Indeed, the default may be sustained solely upon the basis of the contractors' anticipatory repudiation of the existing contract in their formal response to the cure notice.

Gov't Brief to Federal Circuit 40 (May 24, 2002). The Government also briefed this argument extensively in its petition for rehearing:

> The contractors' oral and written statements in the wake of the cure notice unambiguously gave the Government no "continuing sense of reliance and security that the

> promised performance . . . [would] be forthcoming when due. . . . Given this, *AEC* requires, as a matter of law, that the judgment sustain the default be affirmed. . . . The Panel's failure to mention the substantive holding of *AEC* creates the impression that *AEC* may not present the law of the Circuit."

Gov't Combined Pet. for Rehearing and Rehearing *en banc* 5, 6-9 (June 16, 2003).

Defendant contends that the Federal Circuit vacated this court's rulings on the alternative basis that the contractors failed to provide adequate assurances. The 2003 opinion of the appeals court is best understood as leaving open the question of adequate assurances, the Government urges. The remand order does not support such a conclusion. The appeals court gave no direction whether we must address defendant's alternative ground for default, yet it remanded the case to apply *Lisbon*. *See McDonnell Douglas,* 323 F.3d at 1024 ("[B]ecause the Court of Federal Claims did not apply the controlling standard under *Lisbon* to this case, we vacate its ruling that the default termination was justified and remand for further proceedings consistent with this opinion.").

The law of the case doctrine prevents further consideration of adequate assurances in these circumstances. *See, e.g., Am. Satellite Co. v. United States,* 34 Fed. Cl. 468, 480 (1995) ("It is well-settled that if the decision below is correct, 'it must be affirmed, although the lower court relied upon a

wrong ground or gave a wrong reason.'") (quoting *Helvering v. Gowran,* 302 U.S. 238, 245, 58 S. Ct. 154, 82 L. Ed. 224, 1938-1 C.B. 300 (1937), *reh'g denied,* 302 U.S. 781, 58 S. Ct. 478, 82 L. Ed. 603 (1938)). "If the Federal Circuit had accepted defendant's argument . . . it would have affirmed this court's decision on other grounds; the remand order would have been moot. It is reasonable to assume that the Federal Circuit rejected the [argument]." *Am. Satellite,* 34 Fed. Cl. at 480.

Although the Federal Circuit's remand did not address specifically the adequate assurances argument of defendant, further consideration of the issue by this court is precluded by the Circuit's opinion. The Circuit would not have remanded the case for us to apply *Lisbon* if an alternative reason to sustain the default termination existed. Such a gesture would not have been useful.

We have no reason to evaluate the adequate assurances issue differently in any event. The factual findings upon which the earlier ruling depends have been affirmed, or they have not been called into question by the Federal Circuit. The Government has not offered evidence to cause us concern about the prior rulings on adequate assurances.

V. LOSS ADJUSTMENT

Federal Acquisition Regulations give the Government the right to a "credit" for losses the contractors would have incurred had the contractors

performed to completion. *See* FAR 49.203; *McDonnell Douglas Corp. v. United States*, 37 Fed. Cl. 270 (1996) (explaining application of the loss adjustment clause). We held in 1996 that the loss adjustment issue was so intertwined with plaintiffs' arguments relating to superior knowledge and state secrets that neither that matter nor plaintiffs' claim for lost profits could be resolved safely. *Id.* at 272.

The Federal Circuit declined to address the merits of this issue in 1999, stating it was not yet ripe because the question of default remained unresolved. *McDonnell Douglas*, 182 F.3d at 1329-30. The Circuit vacated the rulings on plaintiffs' superior knowledge claim, as well as those for loss adjustment and profits, speculating that the passage of time may have lessened the risks involved. *Id.* at 1330; *see McDonnell Douglas*, 323 F.3d at 1013 (noting the Circuit's ruling vacating this court's loss ratio ruling on earlier appeal).

We readopted the loss adjustment ruling that this and other issues tied to plaintiffs' superior knowledge claim could not be tried because the passage of time did not lessen threats to national security. *McDonnell Douglas Corp. v. United States*, No. 91-1204C (Mar. 1, 2001) ("All of the reasons established by [this court's] December 1996 opinion persist."). We denied the Government's motion for reconsideration in April. The default trial began later that spring.

The 2001 opinion following trial dismissed plaintiffs' superior knowledge claims upon finding that the Government properly invoked the state secrets doctrine. *McDonnell Douglas,* 50 Fed. Cl. at 324-25. We concluded that "[i]ssues involving superior knowledge cannot be litigated safely. Defendant's argument that it is entitled to a loss adjustment pursuant to FAR 49.203 and plaintiffs' lost profits argument are moot." *Id.* at 325.

The Circuit affirmed this court's rejection of the contractors' superior knowledge claim. Noting that the Government owes a duty to disclose certain "critical information" to a contractor, "well-established precedent demonstrates that, when a properly invoked claim of State Secrets privilege undercuts a civil litigant's opportunity to prove its case, the interests favoring the protection of the state secret always prevail." *McDonnell Douglas,* 323 F.3d at 1024. The Federal Circuit did not address loss adjustment arguments specifically. The Government contends this is so because we sustained the default, and defendant did not argue it on appeal.

Defendant asserts the court may enforce the A-12 contract's mandatory loss adjustment provision because it is no longer tied to superior knowledge. That is, because we dismissed plaintiffs' superior knowledge defense, plaintiffs cannot rely on it to argue against this court's application of a loss adjustment. Plaintiffs lack a basis for invoking the doctrine as a defense to enforcement of the provision

of the A-12 contract that mandates application of a loss adjustment.

These are reasonable arguments,[89] but they are legal arguments that we have no need to address at this stage given the judgment entered below. An adjustment under FAR presumes conversion to termination for convenience of the Government. Because we sustain the default termination under *Lisbon*, defendant's loss adjustment argument is moot.

CONCLUSION

This case demonstrates that the contracting officer may have a de minimis role in some circumstances of government procurement, rather than the central role that most contractors assume.[90] The contracting officer need not make termination decisions for the same reasons that a reviewing court

[89] Attorneys for McDonnell Douglas, for General Dynamics, and for the United States have provided outstanding advocacy at the trial level through many years of difficult litigation. Their efforts have assisted the court immeasurably.

[90] Contractors are accustomed to regarding the role of a contracting officer as a central one under the Contract Disputes Act. For example, case law permits the Government to repudiate otherwise legitimate contracts because an official given apparent authority is not the contracting officer. Policy reasons for this practice may be clear, but it gives the contracting officer an exaggerated position in the experience of many contractors.

may consider after termination.[91] So long as information to support the contracting officer's decision was available to the Government at termination, this is sufficient to rule whether the contracting officer reasonably terminated the contract for default for failure to make progress.

The parties had a mutual understanding that this contract would take many years to complete. It was an open-ended contract, as Captain Elberfeld explained: The "final act" of a research and development contract "depend[s] on what they were doing and what they were having problems accomplishing. . . . Until you get to the end, you don't know what

[91] The Government need show only that a contracting officer acting reasonably with the benefit of information available to "the Government" at termination could have been justified in terminating the contractor for default. The information available to the Government need not have been known to the hypothetical contracting officer or, presumably, to the contractor, if a contracting officer could have found himself feeling insecure about contract completion as a result. He need not have included the reasons for his insecurity in the notice to cure or notice of termination. *See, e.g., Divecon Servs., LP v. Dep't of Commerce,* GSBCA No. 15997, 04-2 B.C.A. (CCH) P 32,656 (June 22, 2004) (holding "[w]hether a reason was cited by the contracting officer or even known to him at the time of termination is immaterial. If a valid basis for termination for default existed at that time, we will uphold the decision.") (citing *Empire,* 362 F.3d at 1357; *Kelso v. Kirk Bros. Mech. Contractors, Inc.,* 16 F.3d 1173, 1175 (Fed. Cir. 1994); *Joseph Morton Co. v. United States,* 757 F.2d 1273, 1277 (Fed. Cir. 1985); *Pots Unlimited, Ltd. v. United States,* 600 F.2d 790, 793, 220 Ct. Cl. 405 (Ct. Cl. 1979); *ESC Polytech Consultants, Inc. v. GSA,* 1995-2 B.C.A. (CCH) P 27,629 (1995).)

the last step is." Yet the Government decided to terminate this contract less than three years into performance.

The contractors had reason to expect the Government to approach this contract as it had before, and particularly as it has since. William Anders, General Dynamics' chief executive officer, commented, "[w]e jointly created a bad contract." We have a "mutually bad deal." Few would disagree with that judgment. Mr. Anders added, however, "[the] Government has a responsibility also to fix the contract."

The law does not require the Government to help "fix the contract." The Government can point to reasons in retrospect why plaintiffs were not making the progress that some officials hoped and perhaps expected. So long as those reasons form a rational basis for a reviewing court to uphold defendant's decision to terminate, the court must do so.[92]

[92] The reviewing court may decide whether a contracting officer's belief would be reasonable if it can "decide the actual performance that the contract requires and the amount of time remaining for performance." *McDonnell Douglas,* 323 F.3d at 1017 (citing *Lisbon,* 828 F.2d at 766). The case turns on whether the Circuit's remand meant for the clauses, "entire contract effort" and "contract completion date" to mean exactly what they appear to mean – the contractors' expansive view; or whether the remand permits our use of a more compact yardstick – coinciding with the Government's restricted view. The Government did not establish a contract closing date and the contracting officer did not conduct a *Lisbon* analysis prior to termination.

Defendant's motion for judgment upon additional findings is GRANTED. Plaintiff's cross-motion is DENIED. All pending motions necessarily decided by this ruling are moot and therefore DENIED. The Clerk of Court will enter judgment for defendant. No costs.

s/ Robert H. Hodges, Jr.

Judge